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QUARTERLY JOURNAL

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ECONOMICS

MAY, 1921

SHOULD THE EXCESS PROFITS TAX BE REPEALED

SUMMARY

"We have found the main sources," said President Wilson in his message to Congress of May 20, 1919, referring to federal taxation, "from which it must be drawn. I take it for granted that its mainstays will henceforth be the income tax, the excess profits tax, and the estate tax. All these can so be adjusted to yield constant and adequate returns and yet not constitute a too grievous burden on the taxpayer. . . . The excess profits tax need not long be maintained at the rates which were necessary while the enormous expenses of the war had to be borne, but it should be made the basis of a permanent tax system which will reach undue profits without discouraging the enterprise and activity of our business men."

I

Theory and Practise of the Excess Profits Tax

The thought that the excess profits tax should be so formulated as to be available if necessary for permanent post-war use has profoundly influenced American legislation on this subject from its beginning. When in response to a worldwide concurrence of fiscal need and feeling the munition manufacturer's tax of September 8, 1916 was expanded into the excess profits tax of March 3, 1917, the latter was modeled on the Canadian rather than the British plan. It assumed, or started with, a principal deduction, called now in the statute "the excess profits credit" and referred to here as the "normal deduction" or "normal return." But those who framed the American tax of March 3, 1917 consciously selected a normal (or what they believed to be a "normal") deduction equal to 8 per cent of the invested capital, rather than a deduction based upon pre-war profits; because the former could serve as the basis of a permanent tax, while the latter could not. And in the later contests between the excess profits and war profits principles the leading advocates of the excess profits principle were profoundly influenced by the desire to keep the profits tax in such shape that if necessary it could be permanently retained. Conversely much of the most vehement opposition to the excess profits taxation had its source in the fear that such tax would be foisted permanently upon the country.

This is, of course, not the whole story.[1] The signal victory of the adherents of the excess profits principle

[1] The story up to and including the adoption of the revenue act of October 3, 1917, has been succintly and correctly told in "The War Tax Act of 1917," by F. W. Taussig, Quarterly Journal of Economics, November, 1917, vol. xxxiii, pp. 27–37, in particular.

was principally due, perhaps, to the feeling that immunity from taxation during the war should not be granted to a corporation simply because it had been prosperous and successful before the war. A majority of those who took this view entertained no deep design to perpetuate the excess profits tax. But the leading adherents of the excess profits principle, and the chairman of the Committee on Ways and Means in particular, were consciously animated by the feeling that in this principle the basis for a great and new permanent tax had been found, and that it was important to keep it alive and ready for permanent service.

This conception of the tax is not lightly to be dismissed. It is neither new, revolutionary nor necessarily radical. Early in the year 1863,[1] the state of Georgia adopted a tax on profits graduated in accordance with the ratio between profits and invested capital; and shortly thereafter — by a law approved December 14, 1863 — modified and extended the tax so as to make it practically an excess profits tax, applicable to profits in excess of 8 per cent of the capital stock, at rates from 5 to 25 per cent, varying with the amount of such excess profits. In the first decade of the present century, H. C. Adams repeatedly endorsed a charge or tax of this general nature on differential profit as a necessary accompaniment of rate regulation.[2] When in 1911 the state of Wisconsin, in adopting a general income tax, was confronted with the problem of equalizing the income tax on corporations with an ordinary progressive income tax applied to individuals and partnerships, it based the corporation rate upon the relation between

[1] Possibly in 1862. See Kennan, Income Taxation, p. 213; Kinsman, "The Income Tax in the Commonwealths of the United States," Pub. Am. Econ. Assn., 3d series, vol. iv, pp. 93–96.

[2] This, at least, was the impression that Professor Adams' proposals made upon the writer. See Pub. Am. Econ. Assn., 3d series, vol. vi, pp. 61–66, and vol. ii, pp. 190–195.

the taxable income of the corporation and the value (assessed value for purposes of taxation) of its property used and employed in the acquisition of such income. The kingdom of Norway, also, before the appearance of war excess profits taxes, adopted a corporation income tax in which the rate was graduated in accordance with the rate of earnings upon the capital of the corporation.

Here, in the writer's opinion, are the true precursors, or a few of them, of the excess profits tax as a permanent tax. That the tax could be used to punish the profiteer, check monopoly and "penalize success" were largely the incidental and more or less irrelevant exaggerations which usually accompany fiscal proposals of this nature in a democracy. The real possibility or promise which the permanent excess profits tax held out was the solution of the perplexing problem of adapting the progressive income tax to business concerns. It is unnecessary at this place to prove by reference to financial history and comparative legislation that business inevitably will be taxed and that the proper treatment of business under an income tax offers a peculiarly difficult problem which must be solved.[1] The excess profits tax held out, in theory at least, a particularly promising and attractive solution.

Assuming the possibility of determining normal profits — the profits necessary to elicit a normal amount of investment — the plan proposes to impose business taxes largely on gains in excess of this normal return. Recognizing that taxes on gross income or even on net income are likely to be shifted in whole or in part (particularly when there is a large volume of taxfree securities outstanding), it aims to avoid such shifting by confining the tax to differential or surplus income. Its principal pur-

[1] See T. S. Adams, "Taxation of Business," Proceedings of the 11th Annual Conference under the Auspices of the National Tax Association, pp. 185–194.

pose is to avoid or minimize the repressive effects of inevitable taxes on business. It is in keeping with the best and latest theories of incidence and shifting. It aims at windfalls, the fruits of chance and luck, monopoly gains, war profits and the like; not to satisfy enmity and revenge but to shield the ordinary profits of the ordinary business man, to protect the consumer, and to encourage investment. It offers a justification for — or at least a partial corrective of the evils resulting from — shipping bounties, customs duties, and similar grants of state aid, by providing that in case such assistance results in abnormal profits to private industry, these profits shall be shared with the government. It would furnish, if it could be satisfactorily applied, a strong argument against government ownership, by making the state a partner in private business, sharing its abnormal (i. e., its unnecessary) gains, but not assuming the risks and responsibilities of active participation in the management.

As pointed out several years ago by Henry C. Adams, such a tax fits in harmoniously with the policy of rate regulation or price regulation. We shall probably have more of such regulation as time goes on; and this regulation must, in all probability, be accomplished through general rules which, adapted to the less favorably situated producers, yield excessive returns to the more favorably situated producers. Under such circumstances, a tax upon excess profits makes the results of price regulations more equitable and more attractive. Some such device as this would appear to promote individualism and private industry. Not only land sites, as Henry George emphasizes, but other commercial and industrial opportunities differ enormously. We cannot give to each industry the same opportunities of location, proximity to markets, good shipping facilities, good credit institutions and good government; but we can make inequalities a little less by imposing a tax upon the differential product — upon excess profits. Conceivably then, the excess profits tax may assist materially to promote that equality of opportunity which is as necessary to good business as to good citizenship.[1]

[1] T. S. Adams, "Principles of Excess Profits Taxation," Annals of the American Academy of Political and Social Science, Publication No. 1173, pp. 9, 10.

Included among those who champion the excess profits tax are doubtless some who would keep it for a time in the hope of harassing and ultimately suppressing private business. But most of those who spoke and thought of the possible perpetuation of the tax did so to save and not to destroy private business; to make the taxation of business less and not more repressive; to harmonize the taxation of business income with the taxation of personal income. Business itself will recognize in the next few years, if the excess profits tax be replaced with either a flat income tax or a sales tax, the great practical virtues of a tax which shields from taxation even imperfectly a supposedly normal amount of profit. It is no accident that the tax has been prolonged in Great Britain in order to prevent a levy upon capital and war-made wealth. It is not by lack of thought or through design upon private enterprise that men like Otto H. Kahn and E. R. A. Seligman have declared that the general aim and theory of the excess profits tax are sound.

Such, roughly, in the writer's conception at least would be the rationale and general function of the permanent excess profits tax. In short, as I have stated elsewhere, it would represent the share of the state in the supernormal success of business enterprise. It would take rough toll for the facilities, aid and environment offered by the community. It would be, so far as the federal government is concerned, its expression of a graduated net income tax upon business.[1] But the tax has now been in force in this country for more than three years, during which it has received an amount and kind of study which probably never before have been accorded an American tax, with the possible exception of the general income tax of which it is a part. What are

1 "The Taxation of Business," loc. cit., p. 191.

the teachings of this experience upon the important question, "Shall the excess profits tax be repealed?" and upon the equally important, if less pressing question, "Is it fitted to serve now or in the future as a permanent tax?"

II

Reasons for Immediate Repeal

The reasons for the immediate repeal of the excess profits tax seem to be convincing, even in that calm and long view which in this domain of thought represents the scientific as distinguished from the popular view. Even those who believe that the excess profits tax may at some future date properly and profitably be reinstated should coöperate, I believe, in its temporary withdrawal.

1. Prevailing opinion is worthy of note. To the critics who opposed the tax from the beginning must now be added a large number, probably a majority, of the economists and practically all of the treasury or administrative authorities, most of whom were in the beginning predisposed to favor the tax. Even more significant is the practically unanimous sentiment for repeal among business men. This cannot be ascribed to selfishness. The productivity of the tax is diminishing rapidly, and the law promises to become in the near future "a statute of exemptions rather than a revenue producer." The business man is well aware of this. Nevertheless he works for its repeal. This is partly because of fear of what it may become in the future. But it is ascribable in the main to resentment at its intricacy and capricious inequalities. An able committee of the National Industrial Conference Board, representing the most important business interests in the

country, after months of study of the question, recommends that the excess profits tax be replaced by an additional tax on corporation income not to exceed 6 per cent,[1] making the total income tax on corporations 16 per cent. To most corporations, in the next few years, a 6 per cent additional income tax would represent a heavier contribution than an excess profits tax on the present basis. Under such circumstances, the deliberate decisions of business men who have had intimate experience with the tax as it actually works deserve the most respectful consideration.

2. Passing from opinion to fundamental causes, I find the deepest reason for the repeal of the excess profits tax in the conviction that its continuance would endanger the life of the income tax itself. No federal administration, in my opinion, is capable during the next five or six years of carrying with even moderate success two such burdens as the income tax and the excess profits tax. A lengthy campaign of education, research and reform on the part of the taxpayer, the tax gatherer, Congress, the courts and the experts, including economists, must be carried on, not only before the installation of a permanent excess profits tax would be justifiable, but even before the practical right of the income tax to endure can be assured.

A successfully administered income tax I believe to be an essential part of financial democracy. Personally, therefore, I should regard its breakdown as something in the nature of a political tragedy. Looking at the matter impersonally and historically, it seems inevitable that the income tax shall fill an important, if not the principal, part in our system of federal finance. We must succeed with it. If it breaks down and is withdrawn, it

[1] Not to apply to "public utilities subject to regulation." Reports of the National Industrial Conference Board, Special Number 18, December, 1920, pp. 9, 43–45.

will in time be restored. The time element is important. It is desirable to save the generation or two that would be lost in trying out substitutes and returning to the inevitable path of development if the income tax be, as it is in real danger of being, discredited and discarded. To avert that, it is essential that we learn the rudiments of the game — the proper application of the ordinary graduated income tax — before we attempt its more difficult applications.

3. As a matter of fact, it seems to be beyond doubt that the administration of these two taxes is in danger of collapse. The Secretary of the Treasury describes the complexity of the present law as "clogging the administrative machinery, and threatening, indeed, its possible breakdown."[1] The present Commissioner of Internal Revenue, and his predecessor, D. C. Roper, agree that the administrative burden must be reduced if disaster is to be avoided. Mr. J. E. Sterrett, who from his experience both within and without the Treasury Department speaks upon this subject with unusual authority, says of this tax: "I am satisfied from my knowledge of conditions in Washington that its administration is practically collapsing."[2] It seems unnecessary to heap up evidence to establish this fact. It finds ultimate expression in the probability that the larger and more important returns under the Revenue Act of 1917 will not be finally audited and settled by March 1, 1921, three years after these returns were filed.

Why not improve the administration? The reply is that it will take years to improve it. The intricacy of the excess profits tax is such that it is hardly an exaggeration to say that it takes more time to teach an accountant to master its mysteries than the average

[1] Annual Report of Secretary of the Treasury, 1920, p. 30.

[2] Reports of the National Industrial Conference Board, Special Number 17, p. 117.

accountant can be retained in the service after he has attained such mastery. Many experts or consultants in private practice make from twenty-five to sixty thousand dollars a year, or more; and the public experts are constantly resigning to enter private practice. Among the "key men" in the Bureau of Internal Revenue, the turnover or resignations have frequently been at the rate of more than 100 per cent a year. Tradition, background and continuity of doctrine are sacrificed. The constant shift of ruling and doctrine against which taxpayer's so justly complain is explained in large degree by the incessant change among the men who make the more important rulings. In the higher positions it is practically true to say that nearly all of the best officials enter the service in the expectation of acquiring a technical education and then leaving for private practice. Here is a fundamental weakness of American government which has worried the best minds of the nation since the time of George Washington. Until it is solved, so far as the Treasury Department is concerned at least, the income tax will be in jeopardy and the proper administration of the excess profits tax will be obviously impossible. More elastic salary arrangements would go far to meet the difficulty, but salary adjustment can solve only part of the problem. Public careers must be made for the experts in question; their official positions must be dignified and assured before the federal government can successfully attempt to administer the most difficult forms of direct taxation. A cure will require time, much time. Ten years would be a radically short estimate of the time required in which to bring the taxpayers and the administrative authorities of the country to a point where the excess profits tax could be reasonably well enforced.

This is not the place to diagnose in detail the admin-

istrative trouble with which we suffer. It is sufficient to point out here that the roots of the disease lie deep in the American system of government, deeper even than the comparatively superficial source of infection found in the fact that Congress deliberately insists on keeping the collectors of internal revenue and their immediate appointees, who constitute about one-third of the 18,440 employees of the Bureau of Internal Revenue, outside the requirements of the civil service rules. The trouble is intensified and partially explained by the high administrative ideals which the Internal Revenue Bureau entertains. It aims to find the same and the correct answer to each of the thousands of intricate legal and accounting questions which arise in the application of the tax laws. In Great Britain, according to Professor Haig, much greater administrative elasticity obtains. The administration is far more decentralized and much greater discretion is given both the lower and higher officials.

> In the case of the Excess Profits Duty particularly, with its high rates and its many opportunities for disagreement, it has been considered wise to conduct the administration along broad lines. The assessors have not failed to utilize their administrative discretion. As one of them remarked: "We wipe off £20,000 one way or another as though it were a half-penny." The Board of Inland Revenue has specifically said to the local surveyors that "owing to the present high rates of taxation" they desired "that in doubtful cases the allowances granted in calculating Excess Profits Duty should err on the side of generosity rather than otherwise.[1]

We have only to think of what has happened in the administration of the American property tax, to appreciate how impossible it would be to confer upon subordinate tax officials the discretionary authority which according to Professor Haig has proved so salutary in Great Britain. We must have far more administrative decentralization in this country. Our federal direct

[1] Haig, "The Taxation of Excess Profits in Great Britain," Am. Econ. Review, vol. x, No. 4, Suppl., p. 97.

taxes cannot be successfully administered until the tax officials are invested with more discretion than is now accorded to them. But no such Utopia can be reached here until we have a body of officials and a body of taxpayers skilled by decades of practice in the finer points of income and profits accounting, until Congress revolutionizes its attitude toward administrative discretion, until the collectors of internal revenue and their immediate appointees are brought under civil service rules, and until we have rid ourselves of some of the meticulous legalism which leaves each minute point practically unsettled until it has been formally decided by a court of law. The ultimate source of American administrative weakness is found not so much in Congress or the executive department as in our legalistic traditions and our system of government.

4. Invested capital is chiefly responsible for the administrative burden created by the excess profits tax. Professor David Friday [1] and others have pointed out that the invested capital for the years 1917–20 must be determined whether the tax be repealed or not, and that the computation having been made for one year, it will be easy to keep it up to date. This might seem a conclusive reply to the argument for repeal based upon administrative burden; but two considerations to my mind invalidate it altogether.

The first and less important is the truth that if the excess profits tax be sound, it should be applied to individuals (at least those in business) as well as to corporations. An effort to do this was made in the Revenue Act of 1917. It was unsuccessful. To differentiate business capital and income from the general wealth and income of the typical well-to-do American, with his mixed investments and many activities, is

[1] Profits, Wages and Prices, pp. 190, 191.

beyond our present administrative powers. It is hard to believe that the similar problem is handled with real success in Great Britain where, according to Professor Haig, "about 60,000" assessments[1] of excess profits duty and munitions levy were made in 1917 as contrasted with 34,048[2] individuals, 17,475 partnerships, and 142,619 corporations making returns for excess profits tax in this country under the law of 1917. But, however that may be, it is altogether clear that such a task could not now be successfully performed in the United States.

In this country the excess profits tax on corporations now serves as a rough equivalent for the income surtaxes as applied to the reinvested or undistributed income of sole proprietors and partnerships. The plan is not devoid of rough justice. But no true equilibrium is reached. The excess profits tax compensates for or balances the surtaxes so imperfectly that already Congress recognizes as one of its chief tasks such a modification of the income tax as will make that tax apply equally to incorporated and unincorporated business concerns. That problem is difficult enough. Pending its solution the excess profits tax principle may profitably be held in abeyance for study and consideration. *Furthermore, a supplementary income tax on corporations fairly designed to serve as an equivalent for the surtaxes applied to other taxpayers would probably yield in the next few years a larger revenue than the excess profits tax.* This truth it seems to me clinches the practical argument for the retirement of the excess profits tax.

The second consideration referred to is the fact that the concept of invested capital and the use made of it in the existing excess profits tax are wrong. Because

[1] Loc. cit., p. 96.

[2] Not including those assessed for the so-called 8 per cent excess profits tax under Section 209, Revenue Act of 1917.

they are wrong, the tax results in fundamental and necessary inequalities which make the assessments for 1917–20 of little assistance in providing a sound basis for a permanent tax. The problem is not nearing its practical solution. On the contrary we have not yet found a sound theoretical basis for the tax. These, however, are fundamental criticisms which need the support of more lengthy analysis.

III

Theory of the Present Law

Invested Capital. The essence of the present law is the determination of the normal deduction as a percentage of invested capital. Invested capital is defined on a strict historical or cost basis. In terms the corporation is required to go back to the original investment and start with the cash or property paid in for stock; and strict limitations — in the case of intangible property, rigid and arbitrary limitations — are imposed for the purpose of neutralizing any overvaluations of assets which may have taken place at the time the corporation was organized. Any writing up or revaluation of assets thereafter is prohibited, altho of course in computing the earned surplus included as part of the invested capital it is necessary, theoretically at least, to check or otherwise establish the accuracy of the depreciation, depletion, and profit and loss accounts from the beginning.

Intangible assets built up by expenditures deducted as current expense or developed along with the establishment of a successful business are not recognized in general; and to prevent their recognition through reorganization it is provided that "in the case of the reorganization, consolidation, or change of ownership of

a trade or business, or change or ownership of property, after March 3, 1917, if an interest or control in such trade or business or property of 50 per centum or more remains in the same persons, or any of them, then no asset transferred or received from the previous owner shall, for the purpose of determining invested capital, be allowed a greater value than would have been allowed under this title in computing the invested capital of such previous owner if such asset had not been so transferred or received" (Sec. 331, Act of 1918). This perpetuation of the *status quo ante* March 3, 1917 holds for the purpose of computing invested capital, even tho in general the gain realized in such reorganizations — when book values are written up — is subjected to income tax as distinguished from excess profits tax. On the other hand, revaluation of assets effected through reorganizations made before March 3, 1917 is recognized in computing invested capital, provided of course there was a legal transfer of the assets from an old to a new and distinct legal entity. Fortunate the corporation that through the whim of fate or the financial ambition of its directors or court decrees reorganized and revalued its assets prior to March 3, 1917.

No adequate discussion of the technical details of the invested capital formula can be attempted here.[1] Enough has been said to suggest its principal defects. In large degree the invested capital of a corporation depends upon the time and circumstances of its legal birth, upon the tone of its financial policy, on the character of its bookkeeping. A chance reorganization of the most artificial kind may be responsible for a difference of millions in its taxes. A new corporation starts with a distinct advantage over its older competitors which

[1] See Sections 325–331 of the Revenue Act of 1918; and Regulations 45, Arts. 811–941; and Form 1120.

have been conservatively capitalized; it labors under an equal disadvantage in competing with older corporations which started with watered stock and overvalued assets.

The fundamental error is in the attempt to perpetuate original investment or cost values (modified of course by depreciation, depletion and the like). The attempt is in part impractical. In the case of the oldest corporations and those, like the larger railroads, which represent a combination of many preëxisting corporations, it is literally impossible to follow the letter of the law; and in other cases — through formal reorganizations, statutory "affiliation," accumulation of depletion reserves based upon permitted revaluations or discovery values, and in a dozen other subtle ways — the living fact that investment values do change bursts or seeps through the dead theory of the law, and finds half-suppressed recognition in the invested capital of at least some taxpayers. And where the attempt is not impractical, it is frequently unjust.

This finds expression and illustration in the fact that men frequently buy stock of a corporation, for investment and not for speculation, on a basis wholly disproportionate to any which could be justified by the original investment — or the statutory invested capital of the corporation. Economically such stockholders are the true owners of the corporation. They, as much or more than the corporation, are the real investors. What the original investors put into the corporation decades or generations back is or should be immaterial. The investment changes. Writers sometimes contrast present value of capital with original or invested capital and maintain that both have their appropriate and proper uses. Thus it is frequently held that the present value of capital should be used for property taxation, while

the invested capital — or some modification thereof — should be used for rate regulation. My essential point is that the original invested capital is a fictitious and unreal concept. Given enough time, the investment must and does change, as is illustrated by the fundamental treatment of land values required by the decisions of the Supreme Court in valuations for purposes of rate regulation.

It should be added, however, that the defects of the invested capital formula are easily exaggerated. The arbitrary limitation upon the values of intangible assets originally acquired for stock found in Section 326 of the law has not proved either so troublesome or so unjust in practice as might have been anticipated. Moreover there is a strong and wholesome tendency among corporations which prosper to neutralize by conservative accounting the effects of original stock watering or overcapitalization. I feel confident that "invested capital" fairly represents the capital entitled to a normal return, in a large majority of cases; that in fully 75 per cent of the cases no better figures for asset values could be determined by expert appraisal than the book figures; and that in at least 85 per cent of the cases the value of the assets even on the depreciated cost basis is as great or greater than the book figures. But among the rather large minority are many cases of extreme aberration; and among the last 15 per cent are some very important cases where overvaluation of assets results in an abnormally low tax and deep injustice to conservatively financed competitors.

To return to the assumption of the changelessness of the investment: it is fundamentally unreal, and works in practise the most capricious and indefensible inequalities. Two corporations organize, let us assume, in 1890. Both are successful and the value of their funda-

mental property holdings increases. One reorganizes two or three times before March 3, 1917, taking up each time on the books the appreciation which has taken place and the value of intangible assets which have come into being. In this case both the appreciation and the intangible assets are included in invested capital at the values fairly ascribable at the time of the last reorganization. The second corporation goes through no reorganization. Its taxes will be indefinitely higher than those of the first corporation by reason of the mere fact that it did not chance to go through a reorganization; and in both cases the stockholders may have changed several times.

There are relief provisions found in the law which authorize the rectification of extreme cases of injustice of the kind noted above. But they do not work satisfactorily. The relief is only for the extreme case, and the error or infection subtly pervades the entire tax. Practically every successful corporation has important intangible assets. Whether they have been taken up on the corporation books in such a way as to authorize their inclusion in invested capital is, however, largely an accident.

The Excess Profit Credit. Invested capital serves as the basis of the "normal deduction." Not only the basis but the rest of the process of computing the normal deduction is seriously defective. It is hardly necessary to prove that a flat 8 per cent of the invested capital cannot represent a fair normal deduction for the thousands of classes of business enterprise which must be taxed. Everyone recognizes that the same rate of return which would be fair to banks would be unfair to the men who make a business of prospecting or "wild-catting" for minerals and oil. What is not so generally recognized is the fact that the proper rate of return differs not

only with the class of industry but with the size and precise business of particular taxpayers. Prospecting for oil is a hazardous business, but if conducted on a scale large enough and in conjunction with other branches of the oil industry, the risk and hazard are probably not so great as those involved in operating a hotel or conducting a corner grocery. There are a few mines which can be financed on a lower basis than many banks.

Moreover the classes of business enterprise which would have to be distinguished for this purpose are far more numerous than most persons suppose. Congress has tried, sympathetically, to solve this problem. Proposals to vary the percentage for different types of business enterprise — or to permit administrative authorities to adjust the percentages — have on several occasions met with the approval of the Committee on Ways and Means, but upon a full canvass of the difficulties they have always been abandoned. A partial and comparatively unimportant variation of the rate was authorized for the taxable year 1918 in Section 311(*b*) (2) of the Revenue Act of 1918. Here the percentage deduction was in certain cases fixed "as the average percentage of net income to invested capital, for the pre-war period, of corporations engaged in a trade or business of the same general class as that conducted by the taxpayer." The particular percentages were to be derived from the returns of taxpayers themselves, the median average was to be used, and significantly this average was to be computed for *general* classes only. In other words the problem was put in its easiest and most definite form. But the Bureau of Internal Revenue in administering this provision found it desirable to differentiate 277 "industrial subdivisions."[1]

[1] Bulletin "D," Treasury Department, 1919, p. 13.

I do not believe it is possible to solve this problem by grant of administrative discretion, altho the British practise of increasing the statutory percentage offers an apparent improvement on the rigidity of the American law. But elasticity as between or among classes does not go to the root of the difficulty. We need elasticity within each class. In any well-defined subdivision of industry the new concern, starting to build up a business from the ground, deserves a higher percentage deduction than the old and successful industry which has passed through the perils of the development stage and, having achieved success, has capitalized its assured earning power in such a way as to get this intangible value into its invested capital. We have not solved this question in the field of rate regulation, where the administrative authorities deal with individual cases and take months to work out decisions with every assistance from experts. What could the taxing authorities do with millions of assessments to make and thousands of classes to differentiate?

A large part of the function or service which the percentage deduction is designed to perform should be performed by another device — that of smoothing or averaging profits from year to year. Under the British income tax (not under the excess profits duty) the profits of business concerns may be averaged over a period of years, usually three, for purposes of taxation. Under the British excess profits duty [Sec. 38 (3), Finance (No. 2) Act, 1915] a taxpayer who sustains a loss or whose profits fall short of the point which involves liability to tax is entitled to a credit for such deficiency against any excess profits taxes paid either for previous or succeeding periods. This provision enables the taxpayer in effect not only to credit against years of high income losses of previous or succeeding

years, but enough profits may be taken from the good years to make up for any normal deduction which he might have used in prior years but did not because his profits were then below normal. In other words, the profits of each year are continually smoothed or averaged with the profits which have gone before. In this country Congress only with the greatest difficulty could be brought to authorize for practically one year only the so-called net loss and inventory loss allowances. A thorogoing acknowledgment of the fact that the annual accounting period is too short a time in which to strike a true balance of gain and loss, is a condition precedent to the fair and successful application either of an income or an excess profits tax. Yet such a provision would very seriously reduce the yield of a permanent excess profits tax; and it would seem certain that as the rates of the British excess profits duty decline and lean years follow war prosperity, some modification of the British "set-off for deficiency" will have to be made.

Suppose the normal percentage to have been properly graded to fit the hazards of different undertakings, and provision made to set off the losses and low earnings of lean years against the higher profits of the fat years — what would remain of an excess profits tax during a period of falling profits such as we are now probably entering? Is not the excess profits tax by nature adapted only to periods of war and inflation? I confess to grave doubts about the proper answers to these questions. But I have no doubt that the whole process of determining the normal deduction as a percentage of capital is not only administratively too difficult for us at present, but that it contains so much fundamental error and — particularly this — it ignores so many fundamental elements, that it may be said to be wrong in theory.

The Personal Equation. One of the fundamental elements, not so much ignored as improperly recognized, is represented by the quality and efficiency of the labor and effort expended by the owners of the business. This personal element is supposed to be taken care of by the deduction for salaries. In certain large corporations the salary deduction performs this function with the rough accuracy which alone can be hoped for in tax laws. But among sole proprietors, partnerships and small corporations the salary deduction does not solve the problem with even approximate accuracy. Recognition of this fact was partly responsible for the exemption in this country from the excess profits tax of individuals, partnerships and personal-service corporations. It was almost wholly responsible for the ingenious provisions inserted in both the American and British tax laws for the artificial limitation of the excess profits tax on smaller corporations.[1] But even among large corporations an increasing number of the more important officers are being paid partially or wholly in shares of the net income. These officers are actually receiving "profits" which should be subject to excess profits tax where such a tax is in existence. But these profits bear no relation to any invested capital of a measurable kind.

This personal element pervades practically all business. It is cared for or eliminated so imperfectly by the salary deduction that it introduces an indefinite element of error in the great majority of business concerns when the normal deduction is computed as a percentage of capital. An indirect reflection of this truth is found in the striking statistics prepared by the Treasury Department showing that the excess profits tax when not corrected bears more heavily upon small than upon large

[1] Revenue Act of 1918, Secs. 302, 303. British Finance Act of 1917, 26(4). See Haig, loc. cit., p. 34.

corporations.[1] The remarkable showing of these statistics reflects largely the failure of the excess profits tax of 1917 to eliminate the personal factor. It is possible partly to protect the taxpayer by the use of devices such as those employed in the American and British laws. But how is the government to be protected under laws which exempt personal earnings from the excess profits tax?

Borrowed Capital. Closely connected with the "personal error" noted above are the difficulties arising from the exclusion of borrowed capital. There is space here only to set down somewhat summarily the writer's conclusions in this much debated field. There is a real difficulty here, but it is not to be cured by denying the deduction for interest paid and allowing the borrower to take the percentage deduction on all invested capital whether borrowed or owned. Men with large personal credit frequently do business with stock and equipment merely advanced by others, upon which no interest of the ordinary kind is charged. Frequently the advances are so informal that they can hardly be called capital at all, either borrowed or owned. The proprietor simply sells goods, advanced to him on open account, turning

[1] See Hearings before Committee on Ways and Means, House of Representatives, on the proposed Revenue Act of 1918, Pt. I, pp. 41, 42. The burden of the tax may be measured either as a ratio of tax to net income or as a ratio of net income to invested capital, as there was a direct relation between the two ratios.

RATIO OF NET INCOME TO INVESTED CAPITAL. REVENUE ACT OF 1917

Corporations having invested capital of	Less than 20% (tax less than 12.25% of net income)		20 to 40% (tax from 12.25 to 31% of net income)		40 to 60% (tax from 30 to 40.67% of net income)		60% and over (tax over 40% of net income)		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Less than $20,000....	54	5.1	383	35.9	299	28.1	329	30.9	1,065	100
$20,000 to $100,000 ..	1,671	46.1	1,514	41.7	318	8.8	124	3.4	3,627	100
$100,000 to $500,000 .	1,576	65.0	640	26.4	143	5.9	65	2.7	2,424	100
$500,000 to $5,000,000	518	69.9	171	23.1	40	5.4	12	1.6	741	100
$5,000,000 and over ..	36	85.7	6	14.3	0	0.0	0	0.0	42	100
Total	3,855	...	2,714	...	800	...	530	...	7,899	...

them over so rapidly that no borrowing of capital in the ordinary sense is necessary. This represents an intermediate stage between the ordinary merchant and the full-fledged broker or commission house. The essential source of the trouble is that the normal return in such cases bears no intelligible relation to the capital either borrowed or owned. Tracing the criticisms based upon the exclusion of borrowed capital back to their ultimate source, we find their true significance to be that a sound determination of the normal deduction cannot be made as a multiple or percentage of capital.

IV

Can the Excess Profits Tax be Perfected?

Can practical remedies be found for the defects of the excess profits tax? Perhaps in time, after much further research and reflection.

Administrative Discretion. The principal remedy ordinarily prescribed is a large dose of administrative discretion. Professor Haig (assisted by Mr. George E. Holmes) in his wise and admirable monograph on the taxation of excess profits in Great Britain has emphasized the extent to which administrative discretion is responsible for the superiority of the British law and administration. But this remedy will not save the British tax, if the repeated promises of the British government to repeal the tax at the earliest possible moment are to be taken at their face value. Certainly administrative discretion cannot save the American tax under present conditions.

The principal problems of excess profits taxation were well canvassed before the Revenue Act of 1918 was passed. Its principal defects and abnormalities were anticipated, particularly in the Revenue Act of 1918 as it first passed the Senate. The abnormal or exceptional

cases were classified in Section 327 of the Senate draft, and authority granted to cure them by reference to the experience or treatment of representative concerns. In conference the detailed enumeration of cases as found in the Senate bill was omitted and abstract language introduced which, however, it was definitely agreed should be interpreted to cover the classes of cases specified in the Senate bill.[1]

Section 327 has not proved conspicuously successful. Professor Haig and Mr. Holmes, while praising the plan by which administrative action is taken without public explanation under the British law, criticize it under the American law.[2] The British "Board of Referees does not announce the basis upon which it rests its decision," and its decisions are hailed with acclaim. The principal relief sections of the American law also "are administered by Star Chamber proceedings." But the remedy that affords satisfaction in Great Britain arouses criticism in the United States. "It is natural for him [the taxpayer] to assume, therefore, that the power to assess him is arbitrary, practically unchecked, and wholly contrary to our American principles of taxation. Nor is his criticism entirely without foundation." Here is the essence of the problem. Wide administrative discretion is not suited to the American habit and tradition in matters of taxation. It is not granted ungrudgingly to the administrative authorities by Congress, and it is not exercised freely and boldly by the administrative authorities when it is granted. We are too legalistic successfully to reconcile in the same statute Yes and No. Congress cannot lay down the principle of original investment in Section 326, check the principal loopholes of escape in Section 331, announce that the principle is adopted as a principle, and then expect successfully to

[1] H. R. 12863 (Committee print as agreed to in conference), pp. 133, 134.

[2] Loc. cit., pp. 131, 137, 138.

reduce its rigors by inserting an abstract relief provision calling for free exercise of administrative discretion.

Pre-war Profits. The solution or remedy is not to be found in the use of average or pre-war profits as a normal deduction. This proposal contains a truth of great importance. The principal element, perhaps, in determining normal profits should be past profits, and this is true not only for a war profits tax but for an excess profits tax. A business concern which can truthfully be said to have established a given level or volume of profits, may fairly claim that volume of profits as its normal return.

Yet this also is a truth of limited application. The profits for two or three years before the war do not establish such a normal return. Such profits may have been abnormally high or abnormally low. Consider a heavy investment made in the expectation of distant returns. Here the original investment has more significance than the income record of the company in controlling the normal return. Or consider a corporation, the stock of which is still held wholly or mainly by the original subscribers, and which by some happy combination of circumstances or by starting under some particularly auspicious star had made from the beginning abnormally high profits. This was the case approximately with the automobile industry, which as an industry may be said to have been abnormally prosperous from its real beginning until recent months. Here again accuracy and logic would require that the normal deduction should be based, if not upon capital, at least upon something other than the past profits. Abnormally high profits in the past should constitute no ground for immunity from a future tax on supernormal profits. This is not word play; it is a mere suggestion of the truth that an abnormal state may continue for a considerable time

without becoming "normal." Consider finally the concern which has had abnormally low profits in the past. It is certain that the legislature will recognize this hardship by granting a deduction based on capital or something else than past profits. But if prior profits may be subnormal, they may in other cases be supernormal.

Forgetfulness of this truth is perhaps responsible for the general dissatisfaction with the pre-war profit standard in Great Britain. The latter (like most other devices in the British law) has been used — I think wisely — to save the taxpayer from a rather savage tax levied in times of stress. But in the long run a sound tax statute must protect the government as well as the taxpayer. In any event it is most significant that such dissatisfaction does exist. It was voiced by the Chancellor of the Exchequer in explaining the financial statement of April 19, 1920:

> I would remind the Committee that under the provisions of the Excess Profits Duty prosperous concerns with a large pre-war standard may escape liability for the tax because their present profits, tho high, are not in excess of their standard, and, at any rate, they pay tax on what all of us think an unduly low scale.

It is reflected also in Professor Haig's conclusion that after all the percentage deduction is preferable to a pre-war profits deduction:

> If we are to continue profits taxation, the general standard prescribed in our present law for determining the richness of the profits should be retained. The best British opinion supports the view that a percentage of invested capital is a more satisfactory test than the earnings of some previous period, in a tax of this character, and they have shown how that percentage can be cleverly varied to meet the peculiar conditions in each line of business.[1]

The True Normal Deduction. What then is the true normal deduction? The writer, at least, must answer that question in the words of a wise and liberal Ameri-

[1] Haig, loc. cit., p. 174.

can financier, Otto H. Kahn. "It seems to me that the excess profits tax must go. I am sorry to say it, because in theory it is a wholly just tax. I wish some one would invent a way by which the excess profits tax, or something in the nature of an excess profits tax, could continue. . . ."[1] The original capital invested has in some cases a real significance, but in the majority of cases it should be replaced by some later reproduction value. The percentage deduction should vary with the risk, but in the main the risk element should be eliminated (along with much of the tax) by averaging losses and subnormal profits over a period which should be at least three years in most industries and not less than ten years in some industries. The personal element should be eliminated to the extent that the normal return is figured as a percentage of capital, and yet there are many trades or industries in which the personal element is the chief element and it pervades all business to some degree. At bottom I can see no reason why a lawyer or engineer whose earnings are "supernormal" should be exempt from the excess profits tax. While the separate division of business taxation exists in my mind as one of the indubitable truths of fiscal experience and science, the distinction usually drawn between "business" on the one hand and investment or labor on the other, impresses me as thoroly fictitious from the economic standpoint. The business tax is or should be a tax on every man in his productive capacity.

Scope of the Excess Profits Tax. That brings us to the mysteries involved in the relation between the excess profits tax and other income taxes levied upon personal and investment earnings. We confine the excess profits tax to profits, eliminating wages and salaries on the one hand and interest on the other. But why?

[1] Hearings before the Committee on Ways and Means, December 21, 1920, p. 156.

Consider the investor. He has been lost sight of in this connection, largely because as owner of common stock he was taxed through the corporation, and as owner of bonds or preferred stock he suffered rather than gained by the war and the shrinkage in capital values due to rising interest rates. But under a permanent excess profits tax, in times of peace, he might be the principal beneficiary of state activities. The maintenance of the gold standard, resolute insistence upon credit restriction and deflation, these and similar public policies may in the future greatly increase the income of investors as such.

The large investor is particularly worth considering because he can practically put himself in "business" or take himself out of "business" at will, by incorporating his investments. He can under the present tax law relieve himself of the higher surtaxes on reinvested or saved income and subject himself to the excess profits tax; or, being incorporated, he can bring himself back to the status of mere investor by dissolving the corporation.[1] This gives rise to a most significant paradox. Under the income tax, the man who is wealthy enough to draw a large income from gilt-edged investments with a minimum of risk and effort is threatened with discriminatory differentials against unearned income and is actually subjected to progressive rates exceeding at the maximum 70 per cent. But under the excess profits tax, behind the screen of the corporate fiction, his very excess of wealth and security from risk made him the object of solicitude and exemption. This is true whether he is the sole stockholder or associated with others. The circumstances which under one tax invite attack, under the other justify exemption. Who shall solve this riddle?

[1] The same statement holds true of many forms of personal ability. A number of the most highly-paid movie stars, advertising experts, and engineers have practically incorporated their personal talent. They are in "business" or not as it suits their interests.

Future of the Excess Profits Tax. Whatever may be the ultimate answer to this riddle, I feel certain that the truth lies between the two extremes. The excess profits tax has grievously sinned in overtaxing profits derived from the more hazardous and difficult industrial undertakings. Relatively at least, it has dealt far too tenderly with assured income derived from highly capitalized investments, particularly intangible assets. The income tax also has unduly penalized risk-taking investment and in the face of the vast outstanding volume of tax-free securities has partially defeated its own ends by excessive rates.

And I feel reasonably certain of the direction in which, at this juncture, we should turn our steps. The income tax as a tax upon business — in its relation to men as savers, workers and enterprisers — must be perfected. Its repressive effects upon investment and enterprise must be corrected. Men will not save and invest except in tax-free securities if the income so invested and the fruits of the investment are to be taxed at rates exceeding 70 per cent. The income surtaxes must be reduced at least on that income which is saved and reinvested in "taxable property or business." It is in the treatment of saved and reinvested income that the present income tax deals most differently with corporations and other taxpayers. In reforming the taxation of saved and reinvested income occasion should be taken to place the corporation and other taxpayers on a substantially equal basis. The practical steps or amendments by which to do this have been worked out in a number of different forms, full description of which may be found in the Annual Report of the Secretary of the Treasury for 1920,[1] the Report of the Tax Committee of the National Industrial Conference Board,[2] or the Report

[1] Pages 36–43.

[2] Special Report No. 18, pp. 32–38, 43–47.

of the Tax Committee of the National Association of Credit Men,[1] and recent referendum proposals of the Chamber of Commerce of the United States.

These reforms would greatly reduce the repressive effect of our direct taxes on business. This was the primary object of the excess profits tax as a peace measure — a permanent tax. But it has failed in achieving that object. It should therefore be retired. The reforms of the income tax referred to above involve some additional tax on corporations to compensate for the surtaxes imposed upon the reinvested or undistributed profits of individuals and partnerships. This additional tax, as has already been stated, will probably supply even more revenue than the excess profits tax would yield during the next few years. There is every reason, therefore, to try out necessary and inevitable changes in the income tax, as a business tax, before a final verdict is reached concerning the future desirability and availablity of the excess profits tax. It is not at all impossible that we shall find the answer to our riddle in lower differential rates upon income which is used, not for enjoyment and consumption, but for productive purposes particularly in the more hazardous lines.

Meanwhile the burden of proof is fairly upon the friends of the excess profits tax. Until we can satisfactorily define its true scope and place in the tax system, until we can clearly state how the normal deduction or return should be ascertained, we have no right to ask either for its retention or, after it has been repealed, for its reintroduction.

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[1] "The Undistributed Profits Tax," pp. 22–30. Referendum No. 34, pp. 12–17. See also F. R. Fairchild, "Suggestions for Revision of the Federal Taxation of Income and Profits," Am. Econ. Rev., December, 1920, pp. 785–799.

IS MARKET PRICE DETERMINATE?

SUMMARY

The current doctrine stated, 394. — In fact, demand often does not respond to price in the way assumed, 396. — The penumbra of indeterminate prices, 397. — Cases of fixed seasonal supply, 398. — Supplies that can be carried over, 400. — The demand curve not always negatively inclined, 402. — Speculation does not necessarily stabilise prices, 403. — Commodities produced continuously, 403. — Stock exchange dealings, 405. — The traditional grounds for justifying speculation not applicable to stock exchange dealings, 407. — Application of the present reasoning to dumping, 409. — To war prices, 410. — Conclusion, 410.

The present paper is meant to point out some modifications or corrections of the usual statement of the theory of demand and the interplay of supply and demand. I am by no means sure that the suggestions are novel; nor do they tend to alter the essentials of received economic theory. But they may indicate wherein current versions are not in accord with the course which prices take under some familiar conditions, and thereby they may contribute toward an end of much consequence for the advance of economic science — the ascertainment of the precise relation between the short-period "irregular" phenomena and those long-period "normal" movements which have received most attention from economists.

The foundation of the theory of demand, as usually stated, is the principle of diminishing utility (desirability, gratification, order of preference — whichever term one chooses). From this it follows that successive increments of supply, having diminishing utility, can be disposed of only at progressively falling prices. The theory of demand is simple. The quantity demanded

becomes larger — demand increases — as price is lowered. The demand curve is said to be *always* negatively inclined.

The conditions of supply, to go on with the current version, are more varied. The supply curve may be positively inclined ("diminishing returns") or negatively inclined ("increasing returns") or horizontal ("constant returns"). The equilibrium of demand and supply accordingly is reached under varying conditions. The case of equilibrium deemed typical, and that to which the present discussion may be confined, is reached under positive inclination of the supply curve (diminishing returns, increasing supply price). The illustration by diagram is familiar to all of us: the demand curve slopes down, the supply curve slopes up, and at their point of intersection there is equilibrium of supply and demand.

In this way the conditions of market fluctuations and market prices are supposed also to be indicated. As supply (quantity offered) increases, price falls; but as price falls, that very increase in quantity offered is checked. On the other hand, as price falls, the demand (in the accurate sense of quantity demanded) becomes larger. A lower price drives some sellers from the market, but attracts additional buyers. A new equilibrium is established — new, but under the same conditions of interacting supply and demand. Such is said to be the course of grain prices in an ordinary market; such the equilibrium of daily or weekly prices on any exchange or in any market. Lowered price ensues when a larger quantity is offered in a market; but that lowered price means also that a larger number of bids will be attracted and the fall in price checked.

It does not alter the essentials of this statement if we reject, as Mr. Wicksteed does, the notion of opposing

sellers and buyers, and regard them all as a single group of persons who are maneuvering in essentially the same way. The potential buyer who is likely to be brought into the market by a lower price is also, says Mr. Wicksteed, a potential seller likely to be brought in by a higher price. The whole process is perhaps best regarded not as an interaction of supply and demand, but as the single play of demand, and in the last analysis, of an expression of choices and estimates of choices.[1] It still remains true, and indeed becomes more evident, that a lowered price stimulates purchases. The less the price per unit, the larger the number of units that can be disposed of.

It is just at this point that phenomena appear which are not in accord with the generalizations of the economists. Often lower price does *not* lead to an increase in the quantity that can be disposed of in a market. Neither does it necessarily lessen the quantity that will be offered there. On the contrary it will repeatedly happen that as price falls, less is demanded, not more; and that not less is offered for sale, but actually more. A decline in price, so far from tending always to bring its own remedy through tempting people to buy more, sometimes intensifies itself through inducing people to sell still more. Thus, in a city during many a winter, a fall in the price of eggs may cause the country dealers and the cold storage people not to hold back their supplies, but to send them in hurriedly, for fear of a further fall; while city dealers, so far from buying more, will

[1] "What about the 'supply curve' that usually figures as a determinant of price co-ordinate with the demand curve? I say it boldly and baldly: there is no such thing. What usually figures as such is merely a disguised and therefore unrecognised portion of the 'demand curve.' Diagrams of intersecting curves (and corresponding tables) of demand prices and supply prices are therefore profoundly misleading. They concentrate the attention of the student upon distinctions which have no theoretical relevancy; they co-ordinate as two determinants what are really only two arbitrarily and irrelevantly separated portions of one." Report of British Association for Advancement of Science, 1913, p. 568.

hesitate to buy, having the same fear. The bottom will drop out of the market. On the Chicago Board of Trade the bears, when they sell wheat short and pound away at the price, count on the same course of events. The lower price will not tempt others to buy, but frighten them to sell. Your equilibrium will not necessarily work out at all. It is a toss-up whether a decline in price will check itself by leading to more purchases or will intensify itself by leading to less purchases.

It will be said at once that all this is possible only within limits. A decline in the price of eggs, if considerable, will cause a reaction; in the end buyers will be tempted by lower price. And this is perfectly true. The uncertainty about the working of demand and supply is found only within what may be called the *penumbra:* a phrase and a concept which I submit for consideration and will try to explain.

Consider first a situation in which there may be said to be no penumbra at all. Suppose a fixed supply, unalterable during the period under consideration, and sold on the market by competing sellers to consumers (not to middlemen) for what it will fetch. This is the case which Mill treats as illustrating *the* principle, or law, of supply and demand. There will then be, as he puts it, an "equation" of supply and demand. There is some one price at which the quantity demanded is equal to the (fixed) quantity supplied. At that price we have the equation. And the outcome is not at all uncertain. The process works out infallibly; the resulting price is not subject to manipulation or fluctuation, but is settled once for all.[1]

It is not impossible to find cases which seem in fact to conform to these assumptions, or in which there is at least a sufficient approach to conformity. Some agri-

[1] See the well-known passage in Mill's Principles, Bk. III, chap. ii, §4.

cultural commodities are not only produced seasonally, but almost of necessity are also consumed season by season. Such are potatoes and apples. They can indeed be preserved through a year, and their consumption can be spread over a year; but not over a longer period. Even in these days of cold storage no supplies of either potatoes or apples are kept over; at the end of each season the dealers hold barely enough to connect current consumption with that of the ensuing season; each year's output is consumed during the year, no more or less. Doubtless the same is the case with most fruits and vegetables. Cold storage has wrought a modification for some articles which were formerly in the highly perishable class and were incapable of being carried over from season to season, such as fresh meat and eggs. Fish also — not indeed a seasonable article, but one for which the uncertainties of the catch bring about similar irregularities in the available supply — has been removed from the perishable class. A fare of fresh fish was formerly the most apt illustration of a supply fixed for the time being, which had to be sold at once and without reservation for whatever it would fetch. But cold storage has changed all this. How important is the possibility of lessening the immediate supply by postponing sale will be noted presently. For the moment let us confine attention to the cases in which there seems to be no such possibility — the season's supply of potatoes and apples. Here there would seem to be no indeterminate or fluctuating price, a simple equation of demand and supply, no penumbra at all.

In reality, however, as every one knows, fluctuations persist. An element of indeterminateness evidently remains. There *is* a penumbra within which market prices fluctuate. The general range of the price of potatoes or apples for the season will indeed be approximately de-

terminate; it must be high or low, according to the season's crop and the season's demand. But the general range itself may change considerably in the course of the season, and the prices from week to week and from month to month are likely to show frequent ups and downs. The obvious fact is that there are elements of uncertainty on both sides of the account. Even tho supply be physically fixed, no one knows what is its precise amount. Crop reports may prove inaccurate, unexpected deficiencies or surpluses may be discovered. On the other hand, the effect of price on demand — what is the quantity that can be sold at a given price — is also a matter of some uncertainty. Beyond peradventure a small crop will mean a higher price, but just how much higher? Even the most abundant information on the supplies and the prices of past seasons will leave a doubt about the extent to which the consumers of this year will retrench or expand, will resort to substitutes or eschew them. All these elements of uncertainty, both on the side of supply and on that of demand, must be taken into account by the dealers and speculators. More or less there must be gambling on them. And the state of mind of the dealers themselves adds another element of uncertainty. Some are coolheaded, others excitable. Some are temperamental optimists, others pessimists. Some are shrewd and well-informed; but many go by vague newspaper statement, guesswork, current opinion and rumor. Possibly (I say possibly!) there would be less uncertainty if all sales were to "ultimate" consumers and if utility were to operate on price without intermediate traders and middlemen. The transactions on the market, however, are largely between these middlemen, and the influence of consumers' demand—of purchases checked or stimulated by changes in prices — operates indirectly, affect-

ing the calculations and bids of the buyers and sellers, but is by no means identical with them.

This does not mean that there are unlimited or quite unpredictable fluctuations. The underlying conditions of supply and demand are known for all the staples well enough to make possible a rough prognostication of the season's course of prices. It may be quite clear that potatoes will be higher than last year. But there will be a penumbra of uncertainty. Within this there will be ups and downs, many and perhaps wide fluctuations.

This will, of course, be the case even more with articles further removed from the perishable class. Wheat and cotton, for example, are seasonal products, and in so far may be regarded as fixed in supply for the time being. Indeed, Mill specifically refers to grain as "temporarily . . . unsusceptible of increase of supply; . . . the quantity of corn already existing in the world is all that can be had for sometimes a year to come." Some part of the supply, however, may be carried over from year to year, and the irregularities of seasonal years thus in some degree equalized. This seems to be done to a considerable extent for wheat, and also for cotton. The persons who thus hold over necessarily gamble on the following season's crop. They may profit handsomely, may lose heavily. An accentuation of the same trend through several seasons — a succession of poor crops or of good crops — puts a term to this particular form of speculation. But from year to year there is usually more or less of it; and to the extent that it operates, the season's output is not necessarily identical with the season's supply. Hence there is not so near an approach even to an approximate seasonal equation between demand and supply, between the fixed supply and quantity demanded; since the

supply for the season is itself somewhat flexible. And therefore short period oscillations, from week to week and from month to month, such as we find even when the season's crop is identical with the season's supply, are more certain to occur. There is a wider range for unexpected developments in the situation, for the calculations and guesses among dealers and speculators, optimism and pessimism, waves of sentiment and belief. There is a zone of uncertainty, a penumbra, of considerable extent.

Now it is with regard to the fluctuations within the penumbra, the familiar ups and downs of the market, that we need to be cautious in stating any theory of market price. The daily or weekly or monthly "equilibrium" of supply and demand is a very ticklish matter. To return to the egg market, mentioned at the outset by way of illustration: demand and supply and price are not necessarily connected, for short periods, in the way commonly assumed. Suppose a well-known dealer cuts the price and puts eggs on the market at a lower figure; others follow his lead; the price will fall further; the lower price will quite possibly stimulate still others, not to make purchases, as is usually assumed, but on the contrary to make sales — *until* the edge of the penumbra is approached. Then indeed there will be a reaction, or at least a check. Eggs will not go down indefinitely. But within the penumbra there is no certainty about the effect of lowered price on supply or demand or on the further course of prices. Conceivably the course of events may be just the opposite of that just described. The well-known dealer who cuts his price may be confronted by another dealer equally well-known, who snaps his offers up and bids for more at the same figure. Then still others will follow *his* lead, country dealers will hold back, not force their supplies on the market,

and eggs will go up until the other edge of the penumbra is approached. And so it is, I take it, in the wheat pit or at the cotton post. There is no telling what immediate response there will be to an offer of larger supply or to a decline in the day's or week's quotation. A heavy sale by a big operator and a lower price accepted by him may easily mean, not that more will be bought by others, but that buyers will be scared off and that price will fall still further. This is precisely what the big bear operator expects to bring about. Or the bear's maneuver may not succeed. Price may not fall further; it may rebound and rise.

To put the matter in more technical terms: the demand curve over "short periods" — which may be a matter of weeks or even months — is not necessarily inclined throughout in the same direction. It may be inclined positively.[1] And similarly the supply curve, indicating what quantities are offered for sale at different prices, does not necessarily have that constant positive inclination which is usually assumed. In the course of the higgling of the market this in its turn may have a negative inclination.

The combats of bulls and bears, familiar phenomena of the market, are incomprehensible under the orthodox theory of market price. They can be understood only if we admit that within the penumbra there is no determined or determinable market price. A good observer has said that the successful speculator is not necessarily a man of wide statistical information or of much experience in the trade. But he must be a shrewd judge of

[1] Marshall remarks (Principles, Bk. III, chap. iii, §5; p. 99 in 6th ed.) that there is "one general law of demand . . . the amount demanded increases with a fall in price, and diminishes with a rise in price." Or, as stated in a footnote with reference to the familiar diagram: "the one universal rule to which the demand curve conforms is that it is *negatively inclined* throughout the whole of its length." This proposition doubtless holds as regards "ultimate" demand or purchases by consumers; if not universally, at least with exceptions so few as to be negligible. That it by no means holds universally as regards "market" prices is my main contention in the present paper.

human nature. As regards the fluctuations within the penumbra, there is much truth in the statement. The market may react in all sorts of ways to changes in offers and bids and going prices. The outcome depends on men's hopes and fears and guesses and momentary states of mind. The nervy man may make money by coolly watching his more sensitive fellows and playing on their frailties.

Considerations of this sort, further, may go to explain why it is that commodities in which there is much speculation, so far from being very stable in price, often are not so. The discussion of speculation which is common in our textbooks leads one to expect stability of price in commodities dealt with on a large scale on the exchanges. The facts of the markets by no means uniformly confirm the expectation. The fluctuations in the prices of speculative commodities are great, they are immensely influenced by rumor, they exhibit no clear tendency to quasi-automatic adjustment or to a smoothing off in the fluctuations. This is explicable, it is commonly said, on the ground that many speculators are ill-informed, are not mercantile dealers, are merely the gambling outside public, are outwitted by the professionals. Very possibly; none the less the irregularities are there, and are not readily explained under the familiar formula of supply and demand. Market equilibrium seems to be as far from stability as from predictability.

Leaving now the comparatively simple cases — agricultural products which can most plausibly be treated as fixed in supply for the season — and turning to the less simple but more frequent one of continuous and flexible supply, we may use the same reasoning with even greater confidence. Copper and iron, for example, are continuously produced. Mill undertook to apply his

formula of an equation of demand and supply to commodities of this class, also remarking that at any given time the supply of any and every commodity was fixed. So much was on hand, no more and no less.[1] Now it is obvious that for these, as well as for the seasonal products, there is uncertainty about the precise quantity on hand. Moreover there is the same flexibility as regards the *rate* at which the existing supply will be fed onto the market. And there is the further circumstance that this flexibility of the amount available during the period in which the market is to be fed is of the more influence because the available stock can be increased rapidly by additions to current output. Whatever is on hand in marketable shape can be sold at once or can be sold at a more rapid rate, while the depleted stock can be reenforced through hastened production. We have here a situation that comes nearer to that of the traditional formula. We have a supply that is flexible, and flexible in two ways: as regards the rate at which the commodity comes on the market and also as regards the quantity produced. It is not necessary for the purposes of the present discussion to consider what limits there may be to the extensibility of output — how far the supply even of these goods may after all be regarded as approximately fixed for the time being. Evidently they are not susceptible of unlimited increase. There remains some limitation even of the rate at which they

[1] It is due to Mill to point out that he did not overlook entirely the intricacies of the problem. The very inconsistencies of which he was guilty show that he perceived the problem to be not simple after all. In the section (§ 4) preceding that in which he speaks of agricultural commodities as fixed in supply, he refers to farmers and speculators as withdrawing part of the supply from the market — that is, considers demand and supply as "equalised" for short periods by a *change* in the supply. And in the next chapter he remarks that a decline in cost of production may reduce price, even tho supply be not actually enlarged; the mere probability of change in cost suffices. This is true, but is obviously inconsistent with the doctrine of the "equation." The prompt effect of cheaper production on price ensues through the middlemen and through the rate at which these are led to put on the market the stock already on hand. Mill, like Adam Smith, had glimpses of many important and valid propositions which he touched but momentarily, never working them out in consistency with his main doctrines.

can be rushed on the market. What is here to be noted is that in the first instance it all works out through the same mechanism: the sales and purchases of dealers and middlemen, and their guesses and fancies and tremors. Very likely the middlemen for these "non-speculative" articles are a less susceptible set than the wheat and cotton speculators. The market organization is less perfected and less accessible, and the articles are not standardized to the same degree. Dealings are confined to a smaller knot of experienced brokers and merchants. On the other hand the influence of ultimate consumers and ultimate demand is at least as distant and uncertain. The utility of copper and aluminum, for example, is nowadays highly indirect. The remoteness of the utilities from telephones and power transmission is to be considered, as well as the obvious and immediate utility of pots and pans. The response of demand to new conditions of supply and price is very uncertain. The penumbra is wide. Within it there is much room for fluctuations of opinion and therefore of price, for the influence of an aggressive operator or a commanding firm, and so for indeterminate phenomena.

There is no part of the industrial field to which these general observations apply more forcibly than to stock exchange securities and their prices. To the market prices of these the ordinary reasoning about demand and supply seems to me little applicable. Consequently the ordinary grounds for justifying speculation or for finding results from it which are useful to society become questionable.

The play of demand and supply for the typical stock exchange security is, as we all know, peculiarly subject to manipulation. There are constant offerings and prices that are designed to affect later offerings and later

prices, and do not stand simply for a mere willingness to sell a given quantity now at a given price. Bears and bulls make their drives. It is a toss-up whether the dumping of large amounts of Steel or of Union Pacific at lower than current prices will lead the market to snap them up, or cause a scare and the sale of more of them at still lower prices. The course of prices depends on guesses as to the "technical" position of the market — is it undersold or oversold? — on guesses about the doings of the "insiders," on vague rumors, on epidemics of optimism or pessimism. No doubt, over a considerable period and underlying all the fluctuations, there is the governing influence of the earning powers of the properties. But this too is largely a matter of uncertainty and guess. The only securities for which one can perceive anything like the play of demand and supply as usually formulated are good bonds and the like, yielding a fixed rate of return with risk virtually eliminated. Here we can see offers and demands influenced by price in the orthodox way. But this is simply part of the market for interest on loans, closely connected with the general market for loanable funds. The quotations of most stock exchange securities are loosely connected with the interest market. They are subject to complex influences of their own, among which, whether for short-run or long-run prices, there is even less of the orthodox equilibrium of supply and demand than for speculative commodities like wheat and cotton.

It is obvious that the factor which after all does limit and in a sense govern the price fluctuations of wheat and cotton or of copper and iron, their utility or power to serve human wants, does not operate (unless in a far-fetched sense) on securities. Here there can be no question of ultimate consumers, of diminishing utility, of derived demand, of choices between different goods.

Limits there are, of course, within which the market prices of securities fluctuate. Irregular and indeterminate tho they may be, there is a penumbra within which the fluctuations are confined. The limits, however, are fixed in a different way and the penumbra is wide. These limits are found in such sober and unshakeable expectations as there may be concerning the earning powers of the properties. The most aggressive bear knows that there is a point below which he cannot offer Steel shares without their being snapped up. The range of fluctuation and possible manipulation will vary greatly, I take it, for different securities at different times. The penumbra is of very variable width. But the very limits are not something objective, in the sense in which the utility of cotton or copper is objective. They are estimates and expectations of profits. The long-run or "normal" prices of securities are enormously influenced by factors of essentially the same kind as the short-run or market prices of commodities — opinion and prevision. Tho the long-run prices of securities may not be subject in the same degree as the short-run to rumor and manipulation, they are still peculiarly subject to influence from conspicuous individuals or pervading currents of opinion.

It follows, as was intimated a moment ago, that the grounds on which stock exchange speculation is to be defended and perhaps justified cannot be the same as those adduced to show the social usefulness of speculation in commodities. For the latter, the ground of justification is in essence that speculation promotes maximum utility. By the operation of price advances or reductions the available supplies are so distributed as to be all consumed, no more, no less; consumed, moreover, by those whose offers, as anticipated and gaged by the successful speculators, indicate that they are the

persons to whom utility is greatest.[1] Speculation, it is argued, merely anticipates consumers' demands, and through the influence of price spreads these properly and satisfactorily. This doubtless is valid in the rough, or for the general trend of seasonal prices. I suspect it is difficult of proof for the fluctuations *within* the penumbra, precisely those with which speculation has most to do. Whatever the validity of the reasoning for speculation in commodities, it is not applicable to stock speculation. Here there is no play of utility or of varying gratifications, no adaptation to consumers' demands. True, it might possibly be argued that there is advantageous adjustment of another kind, between present and future; a distribution of gratifications over a period of time, through the operation of the interest rate. We need not stop to consider the subtle problem of analogy suggested by this sort of reasoning. It is applicable at best only to non-speculative securities and the money market. So far as concerns the immensely greater part of stock dealings, there is no room for the arguments about the adjustment of demand and supply or the promotion of maximum satisfaction.

The grounds of defense for stock speculation must be found, if at all, in another direction: that it is a useful part of the machinery of capitalism, promotes investment, advances the production of wealth. It is essentially the ground on which we may defend corporate organization itself, with its system of divided ownership and limited liability of shareholders. By the corporate

[1] This general statement is, of course, subject to the qualification arising from inequalities of income. That qualification should be borne in mind whenever we treat of the relation between utility and price. The present paper does not undertake to consider the far-reaching questions involved, or the extent to which maximum satisfaction is or is not reached by the play of demand under different sorts of social conditions. Assuming, as we may for the purpose in hand, that the existing distribution of wealth is just and the consequent play of consumers' demand conducive to a just distribution of satisfactions, we may identify vendibility with utility and accept the general proposition stated above.

organization of industry risk is divided and limited, investment is made easier and more tempting, accumulation of capital is encouraged, ventures in new fields are enormously promoted. Transferability of shares conduces to the same ends. A person is more likely to invest, especially in novel and hazardous enterprises, if he knows that in case of doubtful prospects or of change in his own circumstances, a sale can be made to another who is willing to step into his place. There is no need of dilating on the topic.[1] It raises questions of the sort that must be considered and if possible answered about the whole system of private property and capitalist control of industry. They are questions of pros and cons, of the balance of advantages and disadvantages, of the acceptance of unwelcome concomitants because the general results are the best within reach. Very disagreeable things happen on the stock exchange, but perhaps the institution is none the less worth while and may even be thought indispensable. What I wish here to emphasize is that the discussion must take a very different turn from that about commodity speculation. The bearing of the two classes of speculative dealings on social welfare, their justification or lack of justification, must be considered for each on grounds of its own.

To return now to the main thread of the reasoning. It bears upon a question which at first sight may seem remote — that of dumping sales. A search is often made for some out-of-the-way and perhaps obscure market, when there is difficulty in disposing of current output at going prices. According to the traditional reasoning, a producer need never have any real difficulty in disposing of the whole of his product or of having on his hands

[1] I venture to refer to what I have said in my Principles of Economics, chaps. 6 and 11.

what he calls a "surplus." He simply needs to lower his price; a large quantity will then be disposed of. In fact, however, a reduction in price is apt to lead, within the penumbra and for sales to the trade, not to larger sales but to smaller. For a period of time which seems to the business man a long one (and indeed is the only period which he usually takes into consideration), and for sales to the persons with whom he deals directly, the probabilities seem to him the reverse of those indicated by the economists. "The trade" will *not* buy more, nay may hold off for a considerable time and not buy at all, in expectation of a possible still greater reduction in price. Hence follows a search for some market where additional sales can be made without spoiling the customary market. Various devices are resorted to in order to reach this end. Goods are put out without the usual brand, or are sold surreptitiously to a few favored purchasers, with stipulations against resale or requirements concerning resale prices. Sales for export are also used for this purpose, especially if the exports are sporadic and do not form a large proportion of the total. Where indeed export business is carried on regularly, the export market becomes as sensitive as the domestic, and needs to be handled with the same caution. Export sales of the sporadic type, however, would seem to be among the phenomena here under consideration.

The reasoning has a bearing also on war prices, war speculation, price-fixing during war times. Under the abnormal conditions of war all prevision of the immediate future is obscured. In a host of transactions it is doubtful whether there can be said to be in any accurate sense an equilibrium of demand and supply. Least of all is an equilibrium to be found when the purchasers in the market are not dealers or other commercial persons, but government agents. No question can enter their

mind concerning ability to dispose of the goods to the consuming public. Their attitude is simply that they must have the goods, irrespective of price. If the price of the commodity they want goes up, they may become uneasy, panic struck, and in hot haste may buy *more*, for fear that the supply will not hold out. Something of this sort happened in the spring of 1917, when agents of the Allied governments bought wheat in Chicago at almost any price asked, determined to get their supply and fearful lest it should not be obtainable at a later date. For them, moreover, consumers' demand was quite immaterial. The governments which bought the breadstuffs were ready to resell to consumers at a loss, if general expediency so prompted them, and indeed did this on a large scale. Under such conditions the penumbra is wide and price is quite unpredictable.

No one supposes that economics is an accurate science, or that the neat arithmetic or diagrammatic illustrations, the mathematical equations and deductions, conform to the facts of the market. They stand only for tendencies; they are compact statements of the underlying trend. We are tempted by our instinct of ratiocination to state the tendencies with undue sharpness of definition. For purposes of exposition we are quite justified in doing so. It is incumbent on us, however, to go further, and to set forth as explicitly as we can in just what way the tendencies work out and how our statements of them need to be modified in view of the complexities and disturbances of actual life. It is chiefly as a contribution to this end that the present paper is offered.

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THE MEAT-PACKING INVESTIGATION: A REPLY

SUMMARY

History of the investigation. Growth and position of the packing companies, 414. — The stockyards situation, 417. — Fluctuations in the price of live stock, 420. — The charge of combination, 421. — The Palmer-Packer agreement, 429.

As an appraisal of the value of the Federal Trade Commission's *Report on the Meat Packing Industry*, Dr. Virtue's article in the August, 1920 issue of this Journal does not tell the whole story. It is true that he frequently points out the shortcomings of the Commission's evidence and findings, but he fails to mention so many evidences of suppression of data, insinuation, and other outstanding weaknesses, that one is tempted to think that his article is, at least in part, a justification of the general conclusions of the Trade Commission, by whom he was employed during a part of the investigation. To what extent Dr. Virtue's personal opinions are justified by his careful selection of data from the report will appear in the following comments on his article.[1]

I. History of the Investigation

In the main, Dr. Virtue's description of the steps that led up to the Federal Trade Commission's investigation is accurate, altho there are one or two important omis-

[1] It is proper to state that Dr. Virtue was engaged by the Trade Commission to do editorial work on that part of the report which dealt with perishable food. He took no part in the meat investigation, and his article, on which Mr. Weld here comments, was based entirely on the published material. It is proper to state also that the article was prepared at the request of the editors of this Journal. — *Editors.*

sions and one or two unwarranted assumptions which place the matter in a somewhat false light.

For example, it is said that the so-called Borland resolution, which provided for a Congressional investigation of the meat industry, was killed because the opposition of the packers was so effective. It is true that the packers fought the passage of this resolution by every legitimate means because they were afraid of a one-sided investigation instead of an impartial inquiry. The resolution itself directed the Federal Trade Commission "to investigate and report to the House of Representatives the facts relating to any or all violations of the anti-trust laws of the United States" by the large packing companies, so that the very wording of the resolution indicated an assumption that the packers were guilty.

Dr. Virtue refers to a conference on the question of the proposed investigation held on January 31, 1917, where it appeared that the views of Mr. Edward N. Hurley, then Chairman of the Federal Trade Commission, were at variance with those of certain advisers of the President. He adds that "on the same day Mr. Hurley resigned." Is this an insinuation that Mr. Hurley resigned because of a misunderstanding or disagreement about the proposed investigation? If so, it is without foundation. Mr. Hurley's resignation was reported in the press of January 5, 1917,[1] altho it took effect on the 31st. There is no connection between Mr. Hurley's resignation and the conference that took place on the 31st of January.

After the investigation by the Federal Trade Commission was finally started, Dr. Virtue rightfully intimates that the packers stood ready to coöperate with

[1] See New York Times of January 5, 1917. The press dispatch was dated Washington, January 4.

the government. As regards crimination and recrimination on procedure, fairness of the hearings, and the like, which appeared as the inquiry proceeded, he says: "About these contentions we need not here concern ourselves." In other words, in an article in which one's object is to give a dispassionate view of the value of the Federal Trade Commission's investigation, he does not consider it necessary to pass on the fairness or unfairness of the methods employed by the Federal Trade Commission in its investigation. Since it has been established that the hearings of the Trade Commission were *ex parte*, and that other methods used in the investigation were unfair and one-sided, failure to discuss this subject would appear to be unfortunate.[1]

II. Growth and Present Position of the Large Packing Companies

The figures selected by Dr. Virtue to illustrate the growth and present size of the large packing companies are not in themselves open to criticism, except perhaps that he resorts too much to combined figures for the five large packers, without warning the reader that such figures are of little significance unless it can be shown that the five packers operate in collusion with each other. His reference to the "dominant position of the large packers"[2] and his use of the word "control,"[2] appear to assume a significance that does not exist.

Dr. Virtue says that everybody knows of the "practical disappearance"[3] of local slaughtering, but says later that the 1909 census figures show that "only about 60 per cent of beeves are handled through meat-packing

[1] See Swift and Company's Analysis and Criticism of Pt. II of the Report of the Federal Trade Commission, pp. 6–9. This subject has also been developed in various Congressional hearings by the writer and others.

[2] Page 635.

[3] Page 632.

establishments." The rest were handled through local retail slaughtering houses, or were killed on farms. There has probably been a somewhat larger proportion killed in meat-packing establishments in 1920, but surely not enough to justify his reference to the "practical disappearance of local slaughtering."

This point is significant in connection with Dr. Virtue's defense of the Federal Trade Commission's contention that locally killed animals should not be included in measuring the "control" that the large packers may have of the meat supply of the nation. He says that the census figures, which show such a large proportion of animals killed on farms and in retail shops, indicate only "that there are certain geographical areas to which the supposed monopoly does not extend." [1] He then refers to the sixty or seventy millions of people in cities and villages who are "dependent upon centralized slaughter for their supply of meat."

In the first place, it is not true that there are "certain geographical areas" to which the activities of the packers do not extend. The farm kill and the country butcher kill take place all over the country in communities where the large packers are selling meats continuously. In other words, the large packers are competing directly at all times with retail butchers who slaughter all or a part of their own meat, and they are also in competition directly with the farmers themselves who kill their own animals. Such farmers, except perhaps a few who are situated at a long distance from the railroads, have the option of killing their own animals or of buying meats at the local butcher shop where meats prepared by the large packers are handled. Furthermore, Dr. Virtue overlooks the fact that every animal killed on farms is part of a potential supply that

[1] Page 635.

might be shipped to central markets and sold as meat in distant cities. As a matter of fact, if the packers, through collusion, increased the price of meats by as much as one or two cents a pound, there is no question but that a large part of this potential supply would quickly find its way in the form of meats to those sections of the country where the price had been artificially raised.

In explaining the extent to which the packers handle other products than meats, Professor Virtue quotes the Federal Trade Commission to the effect that the five packers handle about "half the poultry, eggs, and cheese in the main channels of interstate commerce." [1] It is unfortunate that a brief reference to the question raised concerning the accuracy of this statement is confined to the fine print of a footnote. Dr. Virtue says that in 1917 one company handled 50 million pounds of butter, as an indication of the great importance of the packers in this field. He neglects to state that 50 million pounds was less than 4 per cent of the total butter produced that year in the United States, and only about 7 per cent of the total output of factory-made butter. The five large packers together, in competition with each other, handle less than 20 per cent of the butter, eggs, and poultry marketed in the United States. The proportion for cheese is higher.

Dr. Virtue does well to point out the unfairness of the Commission's insinuation with regard to the "oleo legislative pool," [2] and in general to call attention to the economic reasons for the handling of other products than meats, altho the facts in the case do not "warrant the fear of monopoly" except in the minds of those who are looking for something to fear in spite of what the

[1] Page 636. See Swift and Company's Analysis, p. 93, for discussion of this subject, and for figures giving Swift and Company's proportion.

[2] Page 637.

facts in the case prove. If Dr. Virtue had been more inclined to point out the unfairness of the Trade Commission's treatment of this general subject, he could have mentioned, for example, the Commission's sensational statement that one of the packers in 1917 "sold more than 16,000,000 pounds of rice, thus becoming at a single move, on the statement of the vice president of the company, 'the greatest rice merchant in the world.' During this period the wholesale price of rice increased 65 per cent." [1] The Trade Commission failed to mention the fact that the 16 million pounds of rice handled by one packer amounted to only about 1 per cent of the total amount of rice consumed in the United States. Without making the direct statement, the Trade Commission tried to insinuate that this packer had affected the wholesale price of rice.

III. The Stockyards Situation

The burden of Dr. Virtue's remarks on this phase of the matter appears to be a confirmation of the Federal Trade Commission's charges that stockyards ownership on the part of the packers has resulted in an unfortunate influence over commission men who represent live-stock shippers, and in a certain measure of power on the part of the packers to control live-stock prices. He also upholds the Commission in its contention that the packers have been guided more by a desire for financial profits and an opportunity to control stockyards practises than by a desire to improve the services and facilities of the stockyards.

The case of the Federal Trade Commission and Dr. Virtue with respect to packer influence over commission men and control of prices would be stronger if either

[1] Federal Trade Commission Report on Meat Packing Industry, Pt. I, p. 235.

could bring forth one single bit of evidence that prices had ever been manipulated or influenced, or that commission men have ever let up in their efforts to get the highest possible price for their clients, the shippers of live stock. The live-stock buyers of the packing companies have not been able to notice that commission men are any less zealous in their efforts to get high prices in packer-owned yards than in yards owned by outside interests.

Dr. Virtue attacks the contention of the packers that it has been necessary for them to become the owners of stockyards in order to provide proper facilities and service by referring to evidence in the report of the Federal Trade Commission to the effect that in practically every instance the yards at the various live-stock centers were started by railroads or other outside companies and later acquired by the packing companies. While it is true that most of the stockyards companies were started before the large packers became owners, the contention of the packers still remains true as a general proposition. Swift and Company has often said that two considerations were involved in becoming owners of stockyards: first, to insure adequate facilities and efficient service; and second, the natural desire to obtain any possible financial returns from such legitimate enterprise. The officials of Swift and Company believe that on the whole the matter of developing attractive market places to which live-stock growers would ship their animals has been their primary consideration.

The trouble with the examples recited by Dr. Virtue with respect to such yards as those of St. Paul and Sioux City is that the Federal Trade Commission, on whom he relied, does not tell the whole story. It is true that these yards were started by interests outside the packing industry. Dr. Virtue goes so far as to inform us

that the St. Paul yards, for example, were a financial failure and that inducements were offered to Swift and Company to take them over. He neglects to mention that Swift and Company reorganized the company, improved facilities, and transformed the yards from a dilapidated, unsanitary, and unattractive mud-hole into a modern and sanitary market place. This was not all done in a day, but from first to last there have been invested hundreds of thousands of dollars in this enterprise, and it was not until 1916 that any dividends have been paid — and since then only at the rate of 4 per cent. Such meagre earnings as there had been before 1916 were reinvested in the business to improve and extend facilities. Additional money raised by bond and note issues has also been used for this purpose. This St. Paul experience is typical of the history of other stockyards in which Swift and Company has been interested, and points clearly to Swift and Company's contention that its primary interest has been to develop efficient service and facilities, rather than to make a financial profit out of the operation of the yards.

It is charged that the packers, through their ownership of stockyards, have discriminated against small packers or have prevented them from obtaining sites for plants. It will have to be admitted that herein lies a power that might be abused, and yet the significant fact is that the Trade Commission has not been able to unearth real evidence of any such abuse of power. It relies on hearsay and the complaints of prejudiced parties.

Dr. Virtue says that a clear case of discrimination seems to be made out at the Sioux City Yards.[1] In a footnote he says that Mr. L. F. Swift, during Congressional hearings, tried to explain away these charges,

[1] Page 647.

"but his remarks are not convincing"; he adds that remarks made by the attorney of Swift and Company, Mr. Veeder, "tend to take the edge off the charge of discrimination." The writer would invite any reader of this article who is interested in studying the matter thoroly to read the references cited by Dr. Virtue and also to read the testimony and cross-examination of the writer before the House Committee on Agriculture.[1] It will be found that there is no basis for the charge of the Federal Trade Commission.

As for the rendering companies located at stockyards, both the Federal Trade Commission and Dr. Virtue have given this matter undue prominence. It is true, however, that there is usually but one rendering company in connection with the stockyards, and that such company has virtually a monopoly of the business. Dr. Virtue rightly calls attention to the claim of the packers that this business is usually not large enough for more than one plant to handle, and that it can be handled most efficiently through one company. It remains to be proved that these rendering companies have not been operated satisfactorily, or that they have not paid a reasonable price, on the average, for their raw materials.

IV. Fluctuations in Prices of Live Stock

Dr. Virtue is correct when he says that the Federal Trade Commission resorted to only "general observations and conclusions" on the subject of price fluctuations, and that its findings are not conclusive as to whether the packers manipulate prices. He is also correct when he points out that the live-stock feeder necessarily runs a greater risk in his operations than

[1] Hearings on H. R. 6492, Pt. 26, pp. 1917–1923 (Hurni matter).

does the packer because the feeder has to begin his operations such a long time before he markets his products.

There is, however, one extremely important fundamental fact in this connection, viz., that the lesser time risk of the packer is largely counterbalanced by the extremely small margin of profit on which the packer is forced to do business. The packers do not benefit from the sudden price fluctuations that occur and they have often stated that they are anxious to do anything they can to prevent these fluctuations. In fact, the packers have sought to coöperate with live-stock raisers to find means to bring about a more orderly marketing of live stock and to bring about a more stable market.

V. The Charge of Combination

In his treatment of this most important problem of all — the question whether the large packers act in collusion — Dr. Virtue rightly points out that there is no positive evidence that an agreement exists. His selection of evidence from the Federal Trade Commission Report, however, indicates an attempt to vindicate a suspicion that lurks in his own mind to the effect that there is some kind of combination. In recounting instances furnished by the Federal Trade Commission he does not tell the whole story.

He begins by reviewing the Federal Trade Commission's account of the dressed-meat pools that existed before 1902. He incorrectly states that the "almost continuous" arrangement from 1885 to 1902 was for the purpose of "fixing of beef prices." The pools during the nineties did not fix beef prices. They had to do with the allotment of shipments of fresh beef to various eastern markets in order to prevent recurrent gluts and scarci-

ties. His statement that the packers have admitted that a "combination was in force during this period" is misleading. The packers have of course admitted that they had this arrangement for allocating beef shipments, but they have never admitted that this was an illegal combination in restraint of trade. Dr. Virtue describes the injunction of 1903 as prohibiting among other things the fixing of the quantities of meat shipped. He neglects to mention that the injunction at that time contained the following specific clause:

> Nothing herein shall be construed to prohibit the said defendants . . . from curtailing the quantity of meats shipped to a given market where the purpose of such arrangement in good faith is to prevent the over-accumulation of meats as perishable articles in such markets.[1]

The Federal Trade Commission also omitted this clause from its account of the injunction.[2] In other words, the injunction specifically permitted the continuance of the very practise for which the live-stock pool was organized; and the pool was discontinued, not because it was illegal and not because it was prejudicial to the public interest, but because the packers felt it would be the better policy to do away with an arrangement which the public did not like and did not understand.

In his description of the movement to merge the packing interests in 1903 and the subsequent formation of the National Packing Company, which continued in business until 1912, Dr. Virtue does the packers less injustice than does the Federal Trade Commission, but even here he seems to question the conclusiveness of the court trial of 1912 as a vindication of the packers. If he had been more concerned with an examination of the usefulness of the Commission's report he would have

[1] 196 U. S. 375. See also Swift and Company's Analysis, p. 11.

[2] Pt. II of the Federal Trade Commission's Report, p. 18.

pointed out that the only reference made by the Commission to this important case is contained in the following words:

> . . . after the failure of a criminal prosecution it (the National Packing Company) was liquidated in order to avoid a civil suit.[1]

The 1912 case had to do with the question of whether the National Packing Company constituted a conspiracy in restraint of trade. There was a criminal prosecution and a jury trial, which lasted three months, and the verdict was — "Not guilty." The decision of the court was therefore at variance with the assumption of the Federal Trade Commission that the pooling practises of the earlier period had been carried out through meetings of the directors of the National Packing Company.

As for other evidence of combination produced by the Federal Trade Commission, Dr. Virtue refers to instructions issued to buying-station managers so that they would avoid putting anything into writing that had the appearance of an agreement contrary to law.[2] Later on he says: "Yet one cannot read the correspondence without feeling that the Chicago office was more concerned to avoid the appearance of evil than to avoid the evil itself."[3] He also says that the packers admit there is a tendency among managers to agree on price policies with their competitors.[4] These references apply principally to Swift and Company's country stations for buying cream and eggs.[5] He neglects to mention that the Federal Trade Commission suppressed documentary evidence taken from the files of Swift and Company which contained positive instructions to country agents to refrain from all kinds of price agree-

[1] Federal Trade Commission Report, Pt. II, p. 25.
[2] Page 659.
[3] Pages 662, 663.
[4] Page 662.
[5] Federal Trade Commission Report, Pt. II, pp. 147 ff.

ments as well as to avoid the semblance of collusion. In Swift and Company's *Analysis*[1] Swift and Company reproduces the positive evidence which clears up this point. It appears, therefore, that Dr. Virtue has followed the same policy as the Federal Trade Commission, and that his statement on this matter is unfair and one-sided.

As for his reference to the Trade Commission's charge that there is "rotation in price cutting," Dr. Virtue admits that the evidence adduced by the Federal Trade Commission is "not conclusive," and represents "statements of parties claiming to be injured by the practice."[2] He thinks, however, that the Trade Commission's charges in this matter point to "the probability of an understanding." As a matter of fact the evidence on this point is worthless;[3] unfounded charges should not be accepted as cumulative evidence pointing toward an understanding. Again, Dr. Virtue seems to think there is some significance in the fact that a representative of the Cudahy Packing Company wrote to the Western Meat Company, a Swift concern, that he thought 6½ cents would be a fair market figure for certain cattle,[4] and in the fact that Mr. Sulzberger kept memoranda (referred to sensationally by the Federal Trade Commission as the "Black Book") of interviews that he had with various other packers at infrequent intervals. Dr. Virtue himself admits that there is no evidence of combination in these memoranda. He could have gone further and pointed to positive evidences that competition had reigned and that no fixing of prices or of price policies had resulted from such informal exchange of opinion. And yet Dr. Virtue cites these instances as tho they furnished further cumulative evi-

1 Pages 84–91.
2 Page 661.
3 Swift and Company's Analysis, pp. 69–71.
4 Page 662.

dence leading up to a conclusion which he apparently wants to reach.

Dr. Virtue then goes on to discuss the "question of a live-stock pool,"[1] that interesting phenomenon on which the Federal Trade Commission principally bases its claim that the packers act in collusion. It is assumed by the Federal Trade Commission that since the percentage of purchases taken by each of the five large packers remains approximately constant from year to year, there must be an agreement between the large packers to divide these purchases among themselves. Dr. Virtue, altho admitting that there is no positive evidence of an agreement to divide purchases, has certainly scrutinized the material offered by the Trade Commission with great thoroness in order to find those bits of evidence, which, by themselves and without proper explanation, seem to bear out the Trade Commission's conclusion. He quotes from letters taken from the files of the Cudahy Packing Company where references are made to "our 30 per cent," "all we are entitled to is 30 per cent," etc. To be sure, he introduces in a footnote in fine print the fact that the packers have mentioned that these expressions simply mean the usual share or percentage which each packer naturally seeks to maintain, and that such expressions are common in all industry. He overlooks the fact, however, that the very excerpts he has chosen furnish proof that there was no agreement to divide purchases. For example, take the Cudahy letter where the writer said, "The trouble is that there ought to be about 105 per cent to satisfy everybody."[2] When the situation is properly understood, this expression contains a world of meaning. It simply signifies that each packer is trying to get as large a proportion as he

[1] Page 663. [2] Page 665.

can, without bringing about cutthroat and destructive competition.

Dr. Virtue considers the Armour letter referring to the "50–50 basis" at Denver as "more to the point," but he does not explain that the Federal Trade Commission suppressed figures which showed that Armour had been substantially falling behind on its percentage of cattle purchases in that market.[1] The suppressed figures not only prove that purchases were not being divided arbitrarily, but also explain the concern that was voiced in the Armour letter, about that company's inability to handle as much as Swift and Company in that market.

He is fair enough to state briefly the packer's explanation of the approximately constant percentages,[2] altho he belittles this explanation by offering two or three additional bits of evidence which he thinks have an important bearing on the subject.[3] He considers it significant that the packers had been keeping records of these percentages in their own files. If he could realize how carefully Swift and Company, for example, follows these percentages from month to month, merely to keep a line on its progress in the face of keen competition, he would not be surprised at this fact. He can come to Swift and Company's office at any time and see how these records are kept, and what use is made of them. He again refers to the Sulzberger memoranda in the "Black Book," where percentages are mentioned, but admits that the information there is "scrappy," and "capable of more than one interpretation." He does not explain that the Sulzberger company was at that time having difficulty in keeping up in the competitive race, that the occasional informal conferences were pre-

1 See Swift and Company's Analysis, p. 38.

2 Page 671.

3 Page 670.

liminary to an attempt to dispose of the Sulzberger interests, and that these incidents culminated in a reorganization of the company under the name of Wilson and Company. There is positively no evidence that the exchange of information in these conferences was used as a basis for arbitrary determination of purchase percentages.

In concluding on this matter, Dr. Virtue admits the "soundness and practical wisdom" of the reasoning of packer representatives, but he leaves the discussion more or less up in the air when he adds that "it raises a question as to what kind of competition is left after destructive competition is eliminated." Perhaps the present writer may be able to hazard one or two thoughts which will help to answer this question.

If prices respond quickly and accurately to changes in supply of live stock and to changes in demand for meat; if each competitor strives with all his ability to keep down operating expenses and to improve the quality of his products; if there is ample evidence that profits are at a minimum and that there is no arbitrary power to swell these profits by price manipulation; if there are plenty of positive and obvious evidences that there is keen rivalry and competition in the purchase of live stock and in the sale of meats; if there is evidence that there are plenty of other companies outside of those in question who offer effective competition; then one might safely conclude that even if "destructive competition" has been eliminated there remains the healthiest possible kind of competition — the kind that results in the greatest possible service to the community at large at the least possible expense.

Dr. Virtue then turns to what he calls "collusive practices in buying" [1] — a discussion of what are known

[1] See Swift and Company's Analysis, p. 42.

as "part purchases," "split shipments," and "wiring on." His only justification for the use of the word "collusive" is that the Federal Trade Commission has used it in connection with these practices. He does not furnish one single bit of evidence that there is or has been collusion in buying; nor does the Federal Trade Commission.

These three subjects have been considered at length in Swift and Company's *Analysis and Criticism of the Federal Trade Commission Report*, copy of which may be obtained by sending to the writer at the Chicago office of Swift and Company.[1] A study of this material will reveal that these practices as carried on are perfectly legitimate, that there is no collusion among the packers, and that there has been no manipulation of prices. They continue today, and doubtless will continue in the future. Swift and Company's *Analysis* also shows striking instances of suppression of data on the part of the Federal Trade Commission -- data which refute the very contentions of the Commission. In one instance individual items from telegrams taken from Swift and Company's files were selected to prove a certain point; other items, which proved the opposite, were omitted.

In summarizing the evidence with respect to combination, Dr. Virtue admits that "no formal agreement has been disclosed,"[2] (altho this was definitely charged by the Federal Trade Commission); that there is no absolute monopoly because of the existence of so many small packers; that there is active competition among the five large companies; and yet, he concludes that altho "point after point of the case against the packers may be reasonably explained away," one's mind settles down

[1] "Part purchases," pp. 42 ff.; "split shipments," pp. 48 ff.; "wiring on," pp. 52 ff.

[2] Page 675.

to the belief, "that the theory of a combination is more credible than the explanations." In other words, altho no evidence of combination is found after a most searching examination; altho not a single instance of a manipulated price is discovered; altho there is no evidence that a monopoly profit has been exacted in the packing industry; altho the case of the Federal Trade Commission has been built up through misrepresentation, through suppression of vital facts, and through insinuations and innuendo; one's mind, made up in the beginning that there must be a combination, still clings to this idea in spite of all positive evidence to the contrary.

And even with this disclosure of the state of Dr. Virtue's mind, we find that he is forced to come to the ultimate conclusion that there is merely a "dangerous probability of monopoly," [1] rather than that there is actually a monopoly in existence. To come to such a conclusion after such a seemingly studied attempt to bring together all of the most damaging evidence that can be found, and after omitting to mention the numerous instances in which the Federal Trade Commission suppressed data which controvert its own contentions, is indeed significant. If Dr. Virtue cannot make out a case against the packers after his experience as an employee of the Federal Trade Commission, combined with his experience as a trained economist, no one can.

VI. The Palmer-Packer Agreement

Not much remains to be said about Dr. Virtue's discussion of the Palmer-Packer agreement and the proposed legislation. He might have mentioned, however, that the September and October investigation by the Federal Grand Jury in Chicago in 1919 failed to return

[1] Page 677.

an indictment. He might have mentioned that in the consent decree, as finally issued, the first paragraph specifically says that the packers admit no guilt and that they are not adjudicated guilty. Dr. Virtue seems to realize that the decree results in a backward step from an economic point of view, and that it is not in the interest of efficiency.

On the question of legislation, Dr. Virtue is non-committal. He recites the provisions of the radical laws that have been given consideration in Congress and comes to the conclusion that the question is whether the meat-packing industry is to be considered as a public utility, or whether it should be treated as a private industry. He might well have pointed out that altho the stockyards might be considered as public utilities the packing industry itself is a private industry because it has no natural monopoly and because it buys and sells merchandise at fluctuating prices just like any other private industry. If the packing industry is to be placed under the supervision of a government commission with power to enforce such rules and regulations as it may promulgate, there is just as much reason why every steel mill and every cotton mill should be placed under this form of radical supervision. The time has not arrived when economists or when the American public want the government to step in and endanger the efficiency of a law abiding and efficiently operated private industry through bureaucratic control. The tendency among thinking people is undoubtedly in the opposite direction.

L. D. H. Weld.

Swift and Company,
Chicago, Ill.

THE GOVERNMENT OF THE FABIAN SOCIALIST COMMONWEALTH

SUMMARY

I. The need of reform in the government of Great Britain. II. The Webbs' novel plan, 434. — The Political and Social Parliaments, 438. — Revival of the separation of powers, 440. — III. A new system of checks and balances; its defects, 441. — IV. The "bureaucratisation" of politics, 447; the dictatorship of the "Intellectuals," 451. — Analogies in the Sankey and Plumb plans, 454. — V. The collapse of capitalism, 456; Fabianism vs. Communism, 459.

I

The time-honored British constitution has been much shaken by the stresses and strains of recent years. Even before the war there were signs of increasing difficulty in the working of the parliamentary system. Government by discussion, as patriotic Englishmen liked to describe it, was open to indictment on three separate counts.

First, the volume of parliamentary business had grown so great that time was lacking in which to dispose of it by the traditional methods. Through control over the order of business in the House, the Cabinet was gradually absorbing the whole power of legislation, so far as measures of general interest were concerned. Measures of private and local interest were disposed of by provisional orders and other administrative processes which left to Parliament only perfunctory duties in connection with such matters. The ministers and their permanent non-political subordinates were absorbing the substantial functions of the sovereign Parliament, just as the latter had formerly absorbed those of

the sovereign Crown. Years ago people had learned that the king reigned, but did not govern. Now sovereignty seemed destined to slip from Parliament's weakening grasp, just as it once did from that of the King. Only the Prime Minister and his associates seemed able to handle the tremendous engine which unlimited power to enact legislation has become in modern times.

A second cause of the recent decline in the prestige of the British constitution springs from the inherent limitations of representative government. The issue between two candidates for the same seat in parliament is primarily personal. Under the modern practise of party government through representative bodies a paramount issue or several dominant issues or even a whole party program may be involved in the contest of personalities. But the number of issues which may be simultaneously determined by such an electoral process is not great. In these complicated times, however, the number and variety of the issues which come before the supreme legislative organ of a great empire like the British is very great. The problems of imperial defense and of finance, the relations between the Empire and its self-governing dominions, the government of Ireland, the working conditions of the wage-earning classes, the relations between the state and industry; these are only a few of the issues which must be settled, if possible, with the ungrudging approval of the largest possible portion of the people of the realm. Only a comparatively few can be settled by the election of representatives, even under the most favorable conditions. Under less favorable conditions with some of the people thinking of one set of problems, and others thinking of something else, a popular election may give to the representatives of the people no clear mandate on any-

thing. In the language of political science the general will of the people of the realm cannot be expressed by any single assembly of representatives. In the United States we escape some of the limitations of a representative government like that of England by various constitutional devices, such as federalism, the separation of powers, and the referendum. But none of these exists in the United Kingdom. The few who possess legally unlimited authority to rule have to depend upon their own devices to keep the ship of state true to its course. Largely out of control during the intervals between elections, the ship is steered by ministers of state with an authority scarcely less absolute than that of kings themselves in the days before royalty was divorced from power.

The third cause of the decline of the prestige of the British constitution follows immediately from the first two. If parliamentary sovereignty is slipping into the hands of the Cabinet, over which the people have only a discontinuous and ineffective control, the rights of individuals and of minorities are in danger. The menace of unlimited royal sovereignty was met in England long ago by the exaltation of the authority of the parliament. The menace of unlimited parliamentary sovereignty was met by insistence that parliamentary authority should be exercised through the forms of law, and that the rule of law should be made tolerable by the fullest and freest discussion throughout the law-making process. Now how is the menace of unlimited Cabinet sovereignty to be met? Americans would answer, through a written constitution which shall define the authority of parliaments and courts, as well as of Cabinets and other executive agencies, and establish a balance between them which shall keep each within its constitutional sphere. But this mode of thinking, tho

derived from the principles of the Whig party which long ruled Great Britain in the eighteenth century, is alien to the present habits of thought of Englishmen. Gradually the barriers to which the individual or minority might look for protection against oppression by the ministers of the Crown have been broken down, and nothing has been put in their place. Any minority which cannot hope for a redress of grievances through the triumph of the official minority party, "His Majesty's Opposition," at the next election, is helpless. Partisanship is the principal defense for the liberties of the subject. For members of minor parties such a defense is no defense at all.

On all sides the critics of the old constitution have made themselves heard. Old-fashioned Tories call for a real reform of the House of Lords, and even for some restoration of authority to the Crown. Old-fashioned Liberals call for the relief of Parliament by some measure of administrative decentralization and regional home rule. Modern Radicals call for recognition of the organized producers of the nation as centers of resistance to an overweening central government and demand new barriers against ancient abuses in the form of self-government in industry and guild socialism. And now come Sidney and Beatrice Webb with their proposals for the future government of Great Britain.

II

Few, if any, of the critics have a better right to be heard than the Webbs. The threatened breakdown of the old constitution is in part the direct result of conditions which they foresaw years ago and have had no inconsiderable part in bringing about. Beyond anything else it is the extension of the functions of the state that

has produced the political crisis in Great Britain. None have urged this extension more persistently and systematically than the Webbs. For a full generation the influence of Fabian socialism has been permeating a land where the economic situation has tended more and more to require the adoption of the policies which the Fabian socialists recommended. Now that their propaganda has met with such a large measure of success, or now that so much of what they advocated has been put into effect, what more natural than that many should turn to them for suggestions concerning the best methods of administering the kind of state they have taught their followers to desire. If specific instructions for their followers' guidance are all that is wanted, there can be no disappointment with this latest product of the Webbs' workshop. For here is presented, as the publishers' announcement truthfully proclaims, "something more than a plan for the reform of the old constitution, more even than a plan for nationalization and municipalization with workers' control." With its proposals for the development of the coöperative movement, for the reorganization of the vocational world, and for the coördination of all factors from the Crown to the Works Committee, it boldly sets forth the structural design of a socialist commonwealth.[1]

The Webbs are too shrewd and too experienced in practical affairs to propose a constitution for whatsoever state it may concern or for the ideal socialist commonwealth. They have confined themselves to the task which they best understand and are most competent to deal with, the framing of a constitution for the socialist commonwealth of Great Britain. "Naturally," they admit, "no one is likely to agree with all our detailed proposals. . . . Nevertheless, we think that it may be

[1] Sidney and Beatrice Webb, The Constitution of the Socialist Commonwealth of Great Britain. London, 1919, pp. 364. New York, Longmans, Green & Co. $4.25.

of service to formulate, with sufficient precision to enable them to be understood, the changes in the British constitution and in the social and economic structure of the nation, that seem to us such as a socialist ministry, supported by a socialist majority in Parliament and among the electorate, would probably be led to propose." Thus at the very outset the Webbs disclose their hands. They are going to propose no revolutionary changes in the machinery for carrying on public business. They contemplate with equanimity the prospect of establishing their socialist commonwealth by means of the very agencies for conducting affairs of state which existed before the war; responsible ministries, parliamentary majorities, popular elections. There is no room in their scheme of things for the transfer of all power to a Soviet and the dictatorship of the Proletariat.

Assuming that the capitalist system has broken down, they survey the wreckage with a view to salvaging what may be useful for the purpose of socialist reconstruction. They find much to salvage. First, there is the British Coöperative Movement, surviving in the dual form of voluntary consumers' societies and what the Webbs call obligatory associations of consumers, that is, municipally owned and operated local utilities. Secondly, there is the British Trade Union Movement, the democracies of producers which the Webbs are fond of comparing and contrasting with the consumers' democracies of the coöperative movement. Thirdly, there is political democracy. By the Representation of the People Act of 1918 the goal set up in the famous People's Charter of 1839–48 has at last substantially been attained. The Webbs accept this material as good for the building of the socialist commonwealth. They propose to erect the new structure upon the old foundations. In short, as-

suming that their preliminary assumption is correct, namely that the capitalist system has actually broken down, the Webbs now appear in the guise of conservative reformers. They oppose those impatient critics of the contemporary order of society who would build the ideal commonwealth exclusively upon the principle of production for use, and who would have the users through their associations (democracies of consumers or coöperative societies) control all the conditions of production. They oppose also those other impatient critics of the contemporary social order who would build the ideal commonwealth exclusively upon the principle that the worker shall receive the full product of his labor, and would have the workers through their associations (democracies of producers or industrial unions) control all the conditions of production. Old-fashioned communism and new-fashioned communism alike are rejected by the Webbs.

The Webbs find more formidable opponents in the guild socialists. The younger generation of English Radicals, under the leadership of men like Mr. G. D. H. Cole, have broken the spell of the Fabian tradition and have built up a rival program which the Webbs do not affect to despise. Tho they devote the first part of their argument to a systematic defense of state socialism as the right expedient for the times, they do not fail in the latter part to take account of the proposals of the guild socialists. They explicitly deny that there is any place in a rightly organized socialist state, "the Coöperative Commonwealth of Tomorrow," for a national assembly of vocational representatives. State socialism and political democracy, now and for the future, are declared to be inseparable. If the Webbs' preliminary assumption is correct, the immediate task of the Fabians must be to reënforce the existing structure of British government.

The outstanding feature of their scheme is the suggestion that the functions of the British Parliament be divided between two separate parliaments. One of these the Webbs call the Political Parliament; the other, the Social Parliament. To the former they would entrust the conduct of foreign relations, of imperial affairs, and of the domestic police administration. To the latter they would entrust all legislation of a domestic nature designed to promote the general welfare, and also taxation and finance. To the Political Parliament would be held responsible the secretaries of state for foreign affairs, for war, for India, and for the colonies, the Home Secretary, the chief of the national police under the present allocation of functions, and the First Lord of the Admiralty — all under the leadership of the Prime Minister. But there would be no body of ministers collectively responsible to the Social Parliament. Instead of cabinet government there would be the system of government by standing committees such as characterizes the conduct of local affairs through the British county and borough councils. The members of the Political Parliament would be elected as now by plurality vote in local districts. The Social Parliament, the Webbs concede, might perhaps be best chosen by a system of proportional representation adapted to areas somewhat larger than the present parliamentary constituencies. The Political Parliament would be elected as at present for a comparatively long limited term, subject to dissolution at any time at the will of the government. The Social Parliament, like the existing county and borough councils, would be elected for a shorter fixed term. The power to tax would be vested exclusively in the Social Parliament, tho the appropriating power, so far as concerned the appropriations called for by the budget of the Political Parliament, should be

exercised at a joint session of the two bodies, if unable separately to agree. The budget of the Social Parliament, however, would be voted exclusively by itself.

It is evident that the Social Parliament is intended to be supreme in domestic affairs. There is, however, one significant exception. The enactment of police regulations and of penal legislation will be left to the Political Parliament, and the prosecution of offenders will be left to the government which is responsible to it. In other words, the Social Parliament will be free to promote the general welfare with singleness of purpose, while the Political Parliament will be looked to for the protection of individual liberty and the rights of minorities, so far as compatible with the preservation of the legislative supremacy of the Social Parliament in domestic affairs. By this division of functions the Webbs hope not merely to secure more adequate protection for individual rights than at present, but also to diminish the burden of business now falling so oppressively on a single assembly, and to facilitate the clear and effective expression of the general will of the people on more subjects than can now be brought before the electorate for their decision. They hope to correct the most serious defects of the present scheme of parliamentary government, but not to change the essential nature of the scheme with respect to the conduct of that part of the public business which the custom of the realm has long assigned to the Parliament at Westminster. The newer functions of the state, which they propose to transfer to the jurisdiction of a separate legislative assembly, will also be exercised upon principles in which Englishmen are already in general agreed, for the Social Parliament will be organized substantially upon the principles already tried out and found satisfactory in the field of local government. Since it has been in the latter field that there has been

the greatest development of the functions of government along the lines advocated by the Fabian socialists, the success of the agencies of local government affords to the Webbs a most acceptable precedent for the organization of their new Social Parliament. Despite the name of the new legislative assembly, the thing itself is no less political than the existing county and borough councils.

In short, the Webbs have revived the ancient Whig principle of the separation of powers, but they have given to that principle a novel application. The government of their socialist commonwealth will be a government of checks and balances, but the expedients to which they look for the maintenance of the political equilibrium would have amazed Locke and Montesquieu and Edmund Burke. The Social Parliament has the means of checking the Political by its control of the power to tax and its equal voice in the granting of the political budget. The Political Parliament has the means of checking the Social by its control of the police power and its ultimate responsibility for the maintenance of law and order. As in ancient Stuart times, the power of the purse is to be measured against that of the sword. In place of the legal sovereignty of a single national assembly, as required by the theory of parliamentary government before the war, there will be, not the actual or imminent supremacy of the Cabinet, but a division of sovereignty between two representative assemblies. Those who hold to the dogmas of the analytical jurisprudence which so largely prevailed in later Victorian England will question the feasibility of any such division. But the Webbs are not interested in the subtleties of the Austinian jurists. They profess to build a practicable scheme of government upon the existing foundations. They believe that the old prin-

ciples of the separation of powers and of checks and balances can be adapted to the conditions of the twentieth century and to the exigencies of the socialist commonwealth, and that the revival of those principles will release new energies for the service of the state and establish new safeguards for the protection of the people.

III

Such proposals cannot be expected to escape criticism. Not only theoretical jurists like the Austinians, but many practical Englishmen, with no bias for alternative schemes of reform, such as have been urged by guild socialists and syndicalists and communists and old-fashioned Liberals and Tories, will say that the Webbs' plan will not work. No doubt there are modern instances of somewhat similar schemes. The idyllic constitution prepared by the Italian poet-warrior, D'Annunzio, for his free state of Fiume, contains a scheme, critics would say a fantastic scheme, for government by two separate assemblies with different but coördinate powers. The new constitution of the German Commonwealth, a socialistic commonwealth, too, in its origins, contains a scheme for a National Economic Council to which projects for legislation relating to social welfare must be submitted by the Cabinet and by which they must be approved before they may be considered by the National Assembly or Political Parliament, as the Webbs would call it. But the German National Economic Council is constituted very differently from the Social Parliament proposed by the Webbs, and its relations to the National Assembly are far from comparable to those which the Webbs would establish between their Social and Political Parliaments. The British government itself has established a more comparable scheme in

its recent legislation for the reform of the government of India. But the Montagu-Chelmsford plan for the separation of powers, the dyarchy, as it has been called, is devised to accomplish different ends from those which the Webbs have in view and may be expected to work in an entirely different way. The scheme which the Webbs propose must be approved or condemned upon the general principles of political science; the test of experience cannot be applied.

Whatever may be the general impression upon Englishmen, the Webb's plan for a dual system of representative government will not strike Americans as obviously absurd or impractical. We are accustomed to the idea of two separate governments, each operating directly upon the same body of people, and each supreme in its proper sphere. We have our states and we have our union. Each has its own government with its peculiar functions, and each is held separately to account. We have no difficulty in distinguishing between them. The electorate readily accommodates itself to the task of exercising a dual control. The same is true in every country where the federal system of government is established. The division of powers between the governments of the states and that of the union varies greatly in the different federal states, but all these governments seem to function at least tolerably well, and most of them very satisfactorily. The Webbs' plan has many resemblances to a scheme of federal government. They do not elaborate those portions of the scheme which relate to the conduct of foreign relations and imperial affairs, but it is possible that their Political Parliament might be made to represent the people of the overseas dominions as well as the Englishmen at home. Surely the cabinet might be enlarged for certain purposes by the inclusion of representatives of the self-

governing dominions, as the British War Cabinet was expanded occasionally into an Imperial War Cabinet. Such expansion would not incapacitate ministers for the performance of their special political functions in Great Britain. On the other hand the constitution and powers of the Social Parliament, which of course would exercise jurisdiction only over Great Britain, are not substantially different from what might be suggested for any state belonging to a federal union, with the exception of the omission of the police power. The financial relations between the two parliaments would certainly lead to friction, but friction, if it does not generate too much heat, is a stabilizing force in any government of checks and balances. Whether a stable equilibrium of forces could be established by measuring the power of the purse against that of the sword, as the Webbs propose, is a question that cannot be adequately answered except by experiment. But it cannot be said that stability is impossible.

The defects of the scheme, or rather perhaps of the Webbs' exposition of the scheme, as they appear to an American, are three in number. First, a federal union seems to require a written constitution, and an effective written constitution an independent supreme court to interpret and apply it. The Webbs devote only a footnote to the place of a written constitution and of a supreme court in their socialist commonwealth. The constitution of the Social Parliament will originally be enacted by the present Parliament, like the British North America Act or the Commonwealth of Australia Act, or that creating the Union of South Africa. But the relations between the two cannot be subject ultimately to determination at the discretion of the Political Parliament, or the hoped-for equilibrium between them would be impossible. If the act creating the

Social Parliament should be construed as a compact equally binding upon both — a construction theoretically no more impossible than that adopted by the Supreme Court of the United States in the Dartmouth College case — then the creature would be raised to the same level as the creator. But whether both would remain on the same level might eventually depend on the existence of an impartial supreme court with authority to judge between them. The Webbs make no effective provision for calling in the judiciary to redress an imperiled balance between the two political authorities in their socialist commonwealth. Is it possible that there is some other agency in their scheme of government which they expect to perform a similar function? They do not say.

Secondly, the Webbs have little to say about the place of political parties in their socialist commonwealth. Parties are scarcely mentioned in the text of their book, tho like the supreme court made the subject of one brief but significant note. What effect, they inquire, will the proposed reconstruction of the national government have on the organization of political parties? Will it make for the continuance of the party system? Will it mean two parties or many groups? Or will the party system be superseded altogether? These questions the Webbs promptly dismiss as outside the realm of constitutional reconstruction. This is an amazing indifference to a feature of British politics which during the last two centuries and more has been the very breath of life in the constitutional system. It was the parties that have made the constitution what it is today. Without two parties the system of Cabinet government and ministerial responsibility could not go on as it did before the war. The Webbs' Political Parliament would not function in the familiar way, and

if it is to function differently, they ought to consider how great the differences will be and what will be their effect on the general operation of their scheme. Doubtless the election of the Social Parliament by some system of proportional representation would tend to split the electorate into numerous groups for the purposes of such elections, and that would probably be no serious impediment to the proper functioning of a body which would act largely through standing committees. The Webbs indeed are inclined to think that the organized political parties as they exist today will pass away. But that gives them little concern, since they expect the business of electioneering to be transformed by the devolution of the work on public officers, not politicians, but permanent administrative officials. They appear to put their trust in parties no more than in an independent judiciary. Their confidence is reserved for the permanent under-secretaries and the civil service.

Thirdly, the Webbs do not state clearly the relations they hope to establish between the legislative and executive branches of their proposed government, or, more broadly, between politics and administration in the socialist commonwealth. It might be inferred that they intend to preserve the same relations between the imperial Cabinet and the Political Parliament that now obtain between Parliament and Cabinet. But their indifference to the future of the party system throws doubt upon this inference. The doubt is confirmed by their statements concerning the function of the legislator and the relation between the legislator and his constituents. The future member of the Social or Political Parliament will devote his whole time to the performance of the duties of his office, and will be paid a salary adequate for his full maintenance. He will tend to be regarded "as pursuing a definite vocation requiring no

less continuous devotion to duty and the mastery of no less technique (tho of a different kind) than the vocation of the professional expert or that of the civil servant." Those who pursue the vocation of elected representative "will find themselves relatively impartial as between the ideals of different reformers, in all of which they will discern much that is good, and will be concerned rather to discover how the particular projects of the idealists and the half-articulate desires of the electorate can be adjusted to the circumstances, in such a way as to be made in a democratic community to work for the common benefit." Like the guardians of Plato's ideal republic they will be trustees of the commonwealth, tho, unlike Plato's guardians, they must contrive how periodically they may obtain the sanction of formal public approval for their conduct of affairs instead of securing in advance the support of public opinion once for all time by a magnificent fiction.

The professional politician, therefore, like the expert administrator, will be a bureaucrat. The business of electioneering will be performed by their official subordinates and will be paid for out of the public funds. The political parties will be reduced to the rank of transient propagandist organizations, whose work will consist more in educating the electorate than in lobbying the members of the two parliaments. Under such conditions the elected functionaries may be expected to fraternize easily with those who are appointed to the permanent civil service, and to coöperate readily with them in the conduct of administration. In the case of the Political Parliament this might be viewed with alarm, as likely to undermine unduly the authority of ministers and to enhance to a dangerous extent the influence of the permanent officials; since these would be for the most part members of the military or naval or

domestic police establishments. Probably the Webbs believe that the control of the purse possessed by the Social Parliament will provide an adequate check against the rise of a militarist bureaucracy. In the case of the Social Parliament the process of "bureaucratization," which, under the committee system to be established in that branch of the government, would go much farther than in the other branch, apparently is viewed with complacency, if not with complete satisfaction, by the Webbs. They declare indeed that the control of administration is to be scrupulously separated from the actual conduct of administration. They recognize the distinction between administration and politics, but both functions are to be reserved for the same class of selected men, who will stand above the petty interests and factional spirit and "half-articulate desires" of the average man.

IV

The truth seems to be that the Webbs do not believe in the democracy of the average man. Professor Hobhouse, in his brilliant little book on Liberalism, published some ten years ago, has this to say about what he calls Official Socialism. "Beginning with a contempt for ideals of liberty based on a confusion between liberty and competition, it proceeds to a measure of contempt for average humanity in general. It conceives mankind as in the mass a helpless and feeble race, which it is its duty to treat kindly. True kindness of course must be combined with firmness, and the life of the average man must be organized for his own good. He need not know that he is being organized. The socialistic organization will work in the background, and there will be wheels within wheels, or rather wires pulling wires. Ostensibly there will be the class of the elect, an aristocracy of

character and intellect which will fill the civil services and do the practical work of administration. Behind these will be committees of union and progress who will direct operations, and behind the committees again one or more master minds from whom will emanate the ideas that are to direct the world. . . . Socialism so conceived has in essentials nothing to do with democracy or with liberty."

Official socialism means Fabian socialism; and now the head and front of the Fabian socialism speak for themselves. "It is true," they confess, "that the machinery of administration of any national industry or service — covering an area nation-wide, supplying a thousand separate needs, impinging on ten million families — is and must necessarily be complicated. It is true moreover in a certain sense that this complication is a characteristic of democracy. The simplest of all governmental systems — so at least it seems at first sight — is that of uncontrolled autocracy. The unrestrained dictatorship of the capitalist achieves in industry a similar simplicity — so at least it appears at the outset — by the identity of the ubiquitous motive of private profit, and by the ruthlessness of competition in the struggle for existence. Neither autocracy nor the capitalist system long retains, as a matter of fact, its assumed pristine absence of complications, but is found in practise to become a whole mass of complications, cycles upon epicycles and wheels within wheels, only concealed from the ordinary citizen by business or bureaucratic secretiveness. But however that may be, democracy cannot afford to dispense with complication in its administrative machinery, because only by an extensive variety of parts, and a deliberately adjusted relation among those parts, can there be any security for personal freedom and independence in initiative of the

great mass of individuals, whether as producers, as consumers, or as citizens. It is only by systematically thinking out the function that each person has to perform, the sphere that must be secured to each group or section, the opportunities in which each must be protected, and the relation in which each must stand to the others and to the whole, that in any highly developed society the ordinary man can escape a virtual, if not a nominal, slavery. . . . The price of liberty is the complication of a highly differentiated and systematically coördinated social order."

But who shall do this systematic thinking out of the functions that each person has to perform? Who shall determine the sphere that must be secured to each group or section? Who shall define the opportunities in which each must be protected, and the relation in which each must stand to the others and to the whole? Apparently the Webbs do not intend that this shall be done by the "ordinary man" or even altogether by those elected representatives whose function it is to stand between the ordinary man and his "half-articulate desires." And if not by these, then by whom? Is it by the great class of permanent civil servants, or rather by the more select class of expert technicians among them? Or by those who compose the "wheels within wheels" and the "cycles upon epicycles?" In short who are in the last analysis the guardians of the Fabian socialist commonwealth? The Webbs do not answer.

It is not to be supposed that writers as competent and experienced as the Webbs omit all discussion of matters of such great importance out of ignorance or heedlessness. What they wish to say they know how to say. What they omit is presumably omitted by design. Do they omit the details concerning the organization of the guardians of their commonwealth because they think

their readers will not be interested, or cannot understand, or ought not to be told? They do not say. The esoteric mysteries are withheld.

The argument for real democracy was illustrated by Aristotle long ago, when he said that the cooks may properly be charged with the preparation of the feast, but the ultimate judges must be those who eat it. In modern times this is still true, no matter how many dieteticians, chemists, household economists, and other technical experts may be called in for advice. Democracy cannot be a sham, if the state is to perform successfully all the services which the socialists wish it to undertake. It will fail to fulfill its functions, unless the bureaucracy are true servants and not disguised masters of those whom they are appointed to serve.

The Webbs, whatever may be their ultimate hopes, certainly do not expect to procure the original establishment of their proposed form of government except by democratic processes. Like every important change in the government of Great Britain, their plan will presumably be executed, if at all, as a party measure after a pitched battle with the opposition by a triumphant combination of political forces. Under present political conditions that combination must have the active or passive support of a majority of the nation. The leaders of such a party might well have less insight than the Webbs into the complications of the administrative machinery of the socialist commonwealth and imperfect control over the inner circles of the Fabian samurai; but they would understand the sources of their own power, and they would adopt no scheme which would threaten the foundations of their authority. Whether or not the Webbs' scheme is practicable, therefore, depends in the first instance upon its probable effect on the fortunes of a Liberal-Labor-Socialist coalition. If the

necessary tendency of the scheme is to terminate in a bureaucratic dictatorship, as the Webbs may think, it will not be adopted. If it appears, however, that the wish has been father to the thought and that such a tendency is not inherent in the scheme, the plan might conceivably be adopted, subject to certain modifications. It is undoubtedly based upon a penetrating analysis of the contemporary political and economic situation.

The Webbs are probably mistaken in supposing that their plan will tend to produce a dictatorship of the intellectuals. It would divide the existing Parliament into sections and would, therefore, doubtless tend to weaken the influence of parliamentarians in the conduct of public affairs. It would not divide the professional administrators to a corresponding extent, for they are already divided into the two classes of diplomatic and military officials on the one hand, and the civilian bureaucracy on the other. These divisions would be perpetuated, but the separation of the two parliaments would probably tend to consolidate the several subdivisions of the two bureaucracies more firmly than ever. It is an old saying that the more there is of the more, the less there is of the less. The weakening of the parliamentary influence would strengthen the influence of the bureaucracy, especially of the civilian bureaucracy with its more favorable financial situation. So far the expectations of the Webbs may be well founded. But it is unlikely that the members of the two parliaments, especially of the Social Parliament, would become less dependent on their constituents. In fact members of the British Parliament today are probably less dependent on their constituents than the members of the supreme legislative assembly in any other democratic state. This is the consequence partly of the elimination

from the business of Parliament of most of the private and local matters which so embarrass the members of representative bodies in many democratic states, particularly in America. In part it is the consequence also of the strength of the established political organizations, which makes party regularity the candidate's principal asset at the polls and relieves him from personal responsibility for most of the electoral program, as well as for his conduct in office. The weakening of the parliamentary system, instead of making the member more independent, would have the contrary effect. The subdivision of parties would throw the individual members to a greater extent than now on their own resources, and the introduction of proportional representation, by stressing particular issues more heavily than is possible under any bi-partisan system of politics, would compel members to assume much more extensive personal obligations towards the groups of voters whom they represent than under the present system. They will not become "relatively impartial as between the ideals of different reformers," as the Webbs suppose; but on the contrary more definitely advocates than ever. Doubtless the typical British amateur or "gentleman" politician will more and more give way to the professional, but the type of professional is likely to resemble the representative of special interests, as we know him in America, rather than the disinterested bureaucrat whose coming the Webbs fondly anticipate. This prospect, however, will not appear very terrifying to working party leaders, nor dissuade them from considering the Webbs' plan upon its real merits.

It is doubtful moreover whether the tendency toward concentration of domestic administrative authority in the hands of a disciplined civil bureaucracy would in any event go as far as the Webbs seem to suppose. During

the war all the capitalistic states have been experimenting with socialistic devices. From these experiences much has been learned. In the United States the most significant lesson of the war in this connection is the value of the ordinary business corporation as a form of organization for administering public affairs. Altogether half a dozen of such corporations were organized: the Emergency Fleet Corporation, the War Finance Corporation, the Food Administration Grain Corporation, the Sugar Equalization Board, the Housing Corporation, and the Russian Bureau of the War Trade Board. Business men temporarily in the service of the government, intent on securing quick action and prompt returns, favored this method of administration because it promised relief from vexatious government red tape. A government-controlled corporation is an independent entity with a legal personality of its own. In the absence of special legislation regulating its operations, it can avoid the jurisdiction of the Civil Service Commission and possibly also that of the Comptroller of the Treasury. It can escape from the mesh of rules governing the purchase of government supplies and the letting of contracts. The device sets the business man in government service free to carry on his work in his own way.

Probably these advantages are largely exaggerated, if not specious. Business men presently found that excessive freedom brought its own penalty, and that a certain amount of so-called red tape was necessary for their own protection. The more solid advantages of the corporate form of organization in conducting the public business were of a different sort. It did indeed introduce needed flexibility into government administration, but especially it facilitated the representation of different points of view in the determination of the larger questions of policy arising in the conduct of great en-

terprises. This advantage of the corporate form was recognized in various quarters and was utilized notably by the leaders of the Railroad Brotherhoods in the preparation of the Plumb plan for government ownership and operation of the steam road transportation system of the United States. The Webbs are acquainted with the latter project and compare it favorably in certain respects with the equally notable plan of the Sankey Commission for the nationalization of the British coal industry. The Webbs believe that the device of boards of directors, representing respectively the management, the workmen, and the public, is susceptible of extended application, and that its utilization will do much to open up the administrative bureaucracy and make it more flexible and at the same time more responsive to the various bodies of opinion, political, economic and social, of which it ought to take account. They contemplate indeed the administration of the industries of the nation under the direction of such boards, but they do not indicate the effect of such an arrangement on the position and influence of the permanent civil service in which elsewhere they seem to put their principal trust. Certainly the conduct of the national administration, so far as it falls under the supervision of the Social Parliament, by a series of tripartite boards of directors will not tend to produce the hoped-for dictatorship of the intellectuals.

It is to be regretted that the Webbs did not choose to elaborate the organization of the inner cycles and epicycles of their administrative machinery. In this field of governmental action they are thoroly at home. They could write about inner cycles and epicycles with the assurance of authorities who can justly boast, all of which we saw and much of which we were. This would be not only interesting but highly instructive. Graham

Wallas, himself long one of the Fabians, has taught us the importance of the right organization of official thought and will in modern capitalistic or socialistic society, and has made a helpful beginning in the study of the functioning of a civil general staff. The Webbs could contribute much to such a study. Instead they have repeated what they had already said elsewhere concerning the matters at issue between themselves and the proponents of rival schemes of reform. They reiterate their dissatisfaction with the existing organization of local government. They reëmphasize their early instruction in the limitations of the consumers' coöperative movement. They point out anew the incapacity of democracies of producers to be entrusted with the ownership of the instruments of production in their own vocations. They concede to the guild socialists, to be sure, recognition of a right of self-determination to the members of a vocational association, but their view of the proper limits of self-government in industry is nevertheless thoroly consistent with the views of those who advocate the maintenance of the unchallenged supremacy of the state over all its parts. To the vital questions, however, concerning the location of the center of equilibrium in their system of government, and the manner in which the forces impinging thereon will be organized and controlled, we find no answer. The Webbs note that they found their proposals for administrative reorganization fitted in with the principles enunciated in the Report of the Machinery of Government Committee to the Minister of Reconstruction. With this casual reference to Lord Haldane's comparatively moderate proposals they dismiss that important subject. In short, as we have remarked before, the Webbs, so far as they show their hand, seem to have accepted the rôle of conservative reformers. If so, and if what they say about

the break-down of the capitalist system is true, it is probable that they are now not far ahead of the opinion of that average man whose "half-articulate desires" they generally distrust, but whose support is essential to the realization of their plan.

V

There remains to be considered, therefore, the preliminary assumption upon which the Webbs' plan is predicated, namely, that the capitalist system as a coherent whole has at the present moment demonstrably broken down. The Webbs do not stop to demonstrate the break-down of capitalism. Indeed they expressly disclaim any attempt in this book to frame an indictment of the capitalist system. They do pause at one point to cite with warm commendation Mr. R. H. Tawney's recent monograph on *The Sickness of the Acquisitive Society*. In general, however, they are content, in expounding their plan, tacitly to address those for whom capitalism has lost its moral authority as well as its economic justification. The suggestion that capitalism has actually collapsed or is on the verge of doing so in Great Britain will shock the American not fully conversant with the trend of events in the "tight little island." Capitalism seems so firmly in the saddle in this country, and the results of its violent overthrow in such distant lands as Russia have been represented to be so terrible, that he cannot imagine sober-minded Englishmen talking so calmly of its impending collapse. That raises the question, what do the Webbs mean by capitalism.

Perhaps one can best answer by telling what they do not mean. They do not mean the system of unrestrained competition between owners and users of capital goods

which was the dream of Adam Smith, the breath of life of Nassau Senior, and the despair of John Stuart Mill. That system, so far as it had ever flourished in the great staple industries, has been dead and gone for some time. In some other industries it never succeeded in supplanting the system of independent craftsmanship. That suggests the further question, when did the capitalism celebrated by classical economists of the nineteenth century arise. Every historian knows that no precise date can be assigned. He knows when important inventions were made, when mechanical power was first applied on a large scale in various industries, when manufacturing gave way to machine fabrication; but these changes took place gradually and in different industries at different times. In some industries they have not taken place at all. As with the rise of modern capitalism, so also with its fall: the future economic historian will be unable to assign any precise date.

To the political scientist, if not to the economist, the significant feature of the capitalist system is not the method of production, nor even the distribution of wealth and income, but the distribution of political power. However slow and imperceptible to contemporaries may have been the displacement by the factory system of production of the earlier handicraft and domestic systems, the change in the distribution of power might come with dramatic suddenness. The feudal system fell in France in August, 1789, and presently the capitalist system took its place. In England there was no such dramatic shifting of power. Feudalism was not finally overthrown until the passage of the Parliament Act of 1911. It had already begun to fall at the time of the Wars of the Roses. So it is with modern capitalism. Much power has already slipped from the hands of the capitalists. More is constantly slipping, and the end is not in sight.

There are ample evidences of this tendency even in America. The Transportation Act of 1920, for instance, authorizes a governmental body to establish standards of service on the steam railroads of the United States, to fix rates, to authorize issues of capital, to approve combinations of carriers, to regulate the distribution of cars, and to supervise the maintenance of safe conditions of travel. It authorizes another governmental body to establish standards of employment and compensation, so far as concerns all classes of employees except the higher officials, and to adjust disputes arising in the course of employment. It leaves to the owners of the properties the power to select the executive officers, and to the latter the power to operate the properties subject to the control of the two governmental bodies and power, also, to fix their own salaries, subject to no effective control. Power has almost entirely passed from the hands of the owners, and very largely from those of the executives. Is this capitalism or is it socialism? Economically it is capitalism; politically it is socialism, a form of state socialism under which the railroad bureaucracy is rendered incapable of performing services commensurate with the salaries they are likely to pay themselves. In this instance the trend toward state socialism has gone farther than elsewhere in America. In general it has not gone so far as to warrant the use of any other term than capitalist to describe the existing order of society.

In Great Britain the trend towards state socialism has gone much farther. Tho the predominant power still resides in the hands of those who own capital or are the agents of capitalists, a substantial share of the power has already been acquired by those who have succeeded without the ownership or control of capital in organizing the laboring, consuming, and voting

masses. A little more success to these organizers in the great basic industries and centers of population, and socialist may well be the apter descriptive term to characterize the resulting state of society. Capitalists will continue to be active in industry and in politics, but their authority will be outweighed by that of their rivals in leadership. The transition is not likely to be definitive at any early date. There may be temporary relapses to capitalist predominance in politics, like that in the German commonwealth since the ratification of the Treaty of Versailles. The establishment of the socialist commonwealth is likely to be a protracted and uncertain process, recalling the checkered history of the Third Republic in France. In short Fabian tactics may actually prevail in the struggle for political power between the defenders of the present economic order and its enemies. At some point — perhaps imminent — in the struggle, the balance of power will incline definitively against the capitalists. That event or the present prospect of it is what the Webbs probably mean by the break-down of the capitalist system.

The adoption of Fabian tactics in the constituting of the British socialist commonwealth certainly is most consonant with the political genius of the British people. But under these tactics the consideration of a systematic and complete plan for organizing the public services is not an inevitable task of the rulers of the state. Indeed the plan which the Webbs have proposed may not be designed for strict application by a future Liberal-Labor-Socialist coalition. It may have been published rather to refute the various contemporary attacks on Fabian socialism by the adherents of competing systems of social reconstruction. If this be its purpose, it must be pronounced a very effective production. Whatever may be thought of the Webbs' suggestions for the division of

powers between the Political and Social Parliaments or of their hopes for the development of the administrative bureaucracy, there can be no doubt that they have dealt a heavy blow to the propaganda of the guild socialists, the syndicalists, and the revolutionary communists. Their book will be an arsenal of arguments, a magazine of fertile suggestions, from which future ministers, committed to a moderate policy of state socialism, can draw to meet the attacks of impatient and ultra-radical critics and to devise expedients for dealing with the exigencies of the moment in the conduct of affairs. If this be the true purpose of the authors, theirs is a most timely book, a necessary sequel to their well-known pamphlet, *Labour and the New Social Order*, the authoritative program of the British Labor Party. But it is much more than a supplement to the official platform of the Labor Party. It is a substantial contribution to the literature of modern industry and politics. It will take its place as a worthy companion of the *History of Trade Unionism* and of *Industrial Democracy*.

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REVIEW

LIEFMANN'S GRUNDSÄTZE DER VOLKSWIRTSCHAFTSLEHRE [1]

FOR over two decades there have been signs in Germany of an awakened interest in economic theory. Striking evidence of the momentum of this revival appears in the fact that the first edition of the first volume of Liefmann's Grundsätze (fifteen hundred copies he tells us) could be disposed of within three years amid the shattering events of war and revolution. This surprising sale of a large volume given wholly to theory might, however, be explained in part by the great claims which its author advances. Liefmann's hat is in the ring. He would supersede practically all preceding theory. His conception of economic life, he tells us, "is not only new, but separated by a whole world from the preceding one — is, one might say, almost a different science" (vol. ii, p. 603).

All previous theory is materialistic in that it thinks chiefly of the getting of quantities of material goods. It confuses productive technique with economic calculations and activity. It fails to analyze the fundamental economic factors, which are psychological. Even the Austrian theory, tho bringing in psychological considerations, places them on the materialistic background of the older economics. Psychological and realistic are the adjectives, Liefmann informs us, which best differentiate his system from others. But he also calls it dynamic (not using this term, however, as generally understood by economists), abstractly calculating (*abstrakt rechnend*) and individualistic.

Economic life consists of calculations of utility and cost. Whether as consumer or producer, we all aim at a maximum

[1] Robert Liefmann, Grundsätse der Volkswirtschaftslehre. Vol. i, Grundlagen der Wirtschaft, 2te neu bearbeitete Auflage, pp. xxiii, 708 (1920); vol. ii, Grundlagen des Tauschverkehrs, pp. xvi, 858 (1919).

yield (*Ertrag*) of utility in excess of or in proportion to cost. Cost is fundamentally labor pain-cost. *Ertrag*, Liefmann's darling concept, is usually spoken of by him as an excess over cost. He manages the quantitative comparison of what appear to be incommensurable subjective states, by describing the desire for utility as a lack, a pain (*Unlustgefühl*). Deduct from the pain of wanting a utility the *Unlustgefühl* of laboring to produce it, and you have your *Ertrag*. Now each of us distributes his costs (his labor) so as to secure the same *Ertrag* at the margin of each line of consumption and production. Out of such calculations of individuals arise the prices and incomes of the exchange economy (*Tauschwirtschaft*) which economic theory is to explain. Liefmann's system, therefore, is "individualistic" in its approach to the problems it seeks to solve.

Now what happens to Liefmann's psychological factors when our individuals enter the market? Labor pain-cost apparently drops out. The consumer may have income to spend which never cost him labor. Costs to him, therefore, can only be pecuniary costs. Obviously to the entrepreneur also costs appear mostly in terms of money. So in Liefmann's exposition we get pecuniary costs substituted for the fundamental labor pain-cost, with occasional references, however, to the latter, as "lying behind" the money costs. But *Ertrag* still continues to play its part in the exposition. It is now yield of utility in excess of or in proportion to pecuniary costs for the consumer, and money profits for the producer.

When we come to the explanation of the market value of commodities, we get an account of the factors on the side of demand which is quite in the vein of the Austrian theory which Liefmann professes to reject, except that marginal yield (*Grenzertrag*) takes the place of marginal utility (*Grenznutzen*). Now it may be argued that economic theory is not vitally concerned with a refined analysis of the consumer's or purchaser's states of mind. Grant the existence of a demand schedule as pictured by the curve now so familiar to the reader of English, American, and Italian publications, and the economist has all he needs so far as demand enters into his prob-

lem. But inasmuch as Liefmann professes to have made an important contribution at this point, we may stop to inquire whether his conception of *Ertrag* is really an improvement on the Austrian formulation. That the utility of an article may exceed what is paid for it, is not a new thought. This excess has even been given a name and has been the subject of vexatious controversy among economists. But it is not to be thought of as excess or surplus of utility over the money paid for it (or over the pain-cost back of the money), but as surplus of utility over the utility of other things purchasable at the same price. At the margin of consumption the surpluses vanish. The increment of utility got from any particular commodity is there equal to that of any other commodity within the particular consumer's horizon which may be bought with the same money. There is an equalization (*Ausgleichung*) of utilities, not of surpluses. The equalization of marginal surpluses (*Grenzerträge*) upon which Liefmann lays such solemn stress, is really the extinction of these surpluses.

On the side of the supply of commodities, *Ertrag* appears as pecuniary profit, excess of prices realized over the expenses of production and marketing. The money received may stand in the business man's mind for the utility of what he expects to get with it, and back of his expenses — pretty far back — may be the pain-cost of labor. But virtually Liefmann's system has passed out of its psychological phase into the realm of pecuniary calculations. An extreme nominalist, he regards money as nothing but the abstract unit of accounts. His theory, therefore, begins to assume the title of "abstract calculation." The quantity of any commodity placed on the market is determined by the search for profit (*Ertrag*) which acts in such manner in the competitive industries as to establish a marginal rate of profit. At this point Liefmann brings in some very effective criticism of a common tendency of German economists to speak of "normal or expected or average profit" instead of marginal profit, and to regard such profit as an element of cost.

There is in his exposition a commendable insistence on the connection of all prices in the calculations of both consumers

and producers. He professes, however, to be the first to reveal this connection fully and asserts that only in the case of commodities which have elements of cost in common has any connection been recognized by previous theory. This claim to originality cannot of course be allowed. It is no doubt true that from much of our economic literature a careless reader might get the impression that each commodity gets its price determined apart from the prices of other things. Indeed it is not easy to make the beginner in economics see the connection between prices and the existence of a system or systems of prices. But apart from the general recognition of alternative uses of factors of production, all modern theory also recognizes as determining the demand for any commodity the comparison of its utility with that of other commodities. The relation between prices appears most clearly in the expositions of the mathematical economists but it is necessarily implied, even when not explicitly stated, in the writings of other theorists.

Price is taken by Liefmann to be a monetary expression. He rejects the usual German definition of *Preis* as goods given in exchange, because this is part and parcel of the materialistic economics which he would exorcise. He appears not to perceive, however, that his theory of price, as he discusses it under the head of demand and supply, is a theory of *comparative* price only, that is of *value*, as that term is understood by the classical writers. To make it a complete theory of prices, it needs to be supplemented by a theory of the general price level. So far as the latter receives any attention from him, it is in the discussion of increase of money under the head of factors causing changes in prices. Increase of money, however, is considered side by side with factors affecting particular commodities and relative prices only. In this muddled way of explaining changes in the price level, Liefmann unfortunately does not stand alone among German writers.

His long drawn out description of the general mechanism of demand and supply contains occasional pages of admirably lucid exposition of established doctrine, but the reviewer fails

to discover any considerable contribution to our knowledge. When we come to the problem of what determines the prices entering into the entrepreneur's costs, it is not easy to follow a writer who rejects the tried instruments of economic analysis and disposes of long-standing problems as illusions. The whole doctrine of imputation of shares in the product to the different producers' goods and factors of production employed, Liefmann declares to be nonsense. His arguments against the possibility of imputation show little comprehension of modern theory. One argument quoted with approval from Dr. Mohrmann is a diverting play on words. The imputation theory, says this writer, assumes that in the product we get the *sum* of productive effects of the different factors of production. But production gives a *product* not a sum. It is multiplication not addition. Not bow *plus* arrow equals the bird the hunter kills, but bow *times* arrow equals bird! Entrepreneurs — to go on with his more general criticism — don't value separate producers' goods and factors of production. They just pay for them, and if their total costs fall below the total of prices realized on the sale of the products, there is *Ertrag*. Prices whether for goods or services or factors of production, are determined by bargaining power, by positions of competitive and monopolistic advantage and disadvantage. Capital is simply money cost to the entrepreneur. The gain of capital about which theorists have made such a pother, is very simple. It is the *Ertrag* or profit, and profit is no problem but just the goal and regulative principle of economic activity (Vol. ii, p. 602). It is the materialistic way of looking at things which creates the imaginary difficulties and puzzles of our traditional theory of distribution. Leave aside all thought of quantities of goods and technical services of factors of production, and view bargaining, purchase, and sale simply as turning about money prices (and money no material thing but just abstract unit of accounts), and everything is perfectly clear.

That is, it is perfectly clear to Professor Liefmann. Regarding the whole economic system in its monetary aspects, one might get the idea that all that is necessary to assure a gain to

capital is that the annual total of incomes spent for consumers' goods shall exceed the annual total of sums invested or re-invested. The proportion of this excess would account also for the rate of return (the average, not the marginal rate). But such a way of looking at the matter is too collectivistic, not individualistic enough even to occur to Liefmann. As it is, he leaves the matter of the existence and rate of capitalistic gain a mystery. He denies that there is any reason for regarding the existence of interest on capital as more of a problem than the payment of wages to the laborer or of rent to the land-owner. He remarks that if the rate of interest appears insufficient, funds will be spent for consumers' goods rather than devoted to investment, but this idea does not lure him on to the formulation of an abstinence or time-preference theory. Land in its money cost, we may note in passing, is capital to Liefmann, and land rent therefore is merged with income of capital.

He rejects the concept of distribution as materialistic and "sociological" (collectivistic) and announces that in future he will ignore discussions based on the idea of a division or distribution of the total product of society. What benighted theorists still consider under that title, Liefmann takes up under the head of *Einkommenslehre*. The idea of substituting a theory of incomes in place of one of distribution is not new to German literature, but was introduced by Philippovich some years ago in his *Grundriss der politischen Oekonomie*. In Liefmann's treatment, it falls easily into place in the pecuniary system of economics. Incomes (money incomes) arise as *Erträge* out of prices and the spending of incomes determines prices; and thus the circle is closed.

In place of the four traditional shares in distribution Liefmann considers a greater number of different kinds of income. For unskilled labor he sets forth a subsistence theory of wages. This, however, is not given the usual Malthusian basis but is supported by the curious argument that if wage-earners receive less than the money wages necessary to maintain their standard of living under the existing scale of prices, the consumers' goods which they are in the habit of pur-

chasing will fall in price and they will receive the same real income. *Per contra,* if they get higher wages, prices of consumers' goods will rise and they will be no better off. Comment seems unnecessary.

A formulation of economic theory in terms of money prices rather than in terms of value and of quantities of goods has some pedagogical advantages. The reviewer is disposed to regard it as the only feasible method of presenting the subject to the undergraduate. But in opposition to Liefmann, Cassel (*Theoretische Sozialökonomie,* 1918) and some of our American insurgents, it may be maintained that such a method is not complete and that to the seasoned theorist there is a gain in stripping off the monetary side of economic phenomena to get at fundamental factors, to think in terms of value rather than of price. Liefmann regards as one of the chief causes of error in the prevailing theory the persistent attempt to look behind the money veil. He makes the veil itself his theme. But if he had been less fascinated by it, he might not have overlooked so completely certain important problems. For instance, there is in these bulky volumes on the *Grundsätze* of economics no consideration of the character of the capitalistic method of production nor of the part played by capitalists in increasing or maintaining our productive apparatus. Altho he condemns the great work of Böhm-Bawerk *in toto* (vol. ii, p. 379) Liefmann might have profited by a careful study of it.

It is, of course, not easy to appraise Liefmann's theorizing in all its ramifications, even were it worth the effort. He writes an easy, fluent style, and the book contains interesting, passages. On the whole there is little reward for the pain-cost of going through its fifteen hundred pages. His understanding of the existing body of economic theory is astonishingly superficial. It is conceivable that a vigorous mind unhampered by what others have accomplished might attain to new and valuable ideas. But when a writer with all the prestige that goes in Germany with academic position puts forth such vast claims to originality as does Professor Liefmann, he should have informed himself conscientiously of what has already been done in the field. A long catalog could be made

of his misconceptions of other writers and of his reckless generalizations in regard to prevailing theoretical tendencies. Here and there in his many critical passages he scores a point, but often it is about matters largely verbal in character. Such criticism, of course, may have value. There are altogether too many careless expressions current in economic literature and their gradual elimination is much to be desired. But it is not easy to make exposition of complicated matters absolutely fool-proof and often it is not worth trying. "Life is not long enough for us to express, either in speech or in writing, all the limitations and reservations which we leave implicit in our statements." [1]

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[1] Henry Higgs in the Economic Journal, June, 1920, p. 244.

NOTES AND MEMORANDA

EARLY HISTORY OF THE TERM CAPITAL

It would not have been at all surprising if the adjective capitalis, formed by the Romans from their substantive caput, which is the Latin for our substantive "head," had been applied by them to many different things. We ourselves, using "head" adjectively or in composition with a hyphen, talk of head-keepers, head-offices, head-quarters and many other head things. But, if the dictionaries are to be trusted, Latin writers of the classical period generally confined their use of capitalis to the sense in which we, following them, use the adjective "capital" in applying it to crimes and punishments — the sense of "having to do with life." But they did sometimes use it in what to us, with our belief that the head is the seat of personality, seems the more obvious sense of "most important." In later ages this use became common, so that the French speak of "la ville capitale d'un pays," "le point capitale de l'affaire," and the English used to speak of "the capital messuage" and still speak of "the capital city of a country," and "the capital merit" of a work, and many other things.[1] In this sense it is synonymous with "chief," which is itself nothing but the French chef, a softened form of caput.[2]

Now if we ask ourselves what is the chief sum of money dealt with in any particular business, whether that business is carried on by an individual or by a small number of partners such as we call a firm or by a larger number of partners such as we call a company, the answer is "the sum which is the foundation of the business, the total of money on which the individual, firm or company carries on trade." At first this is,

[1] A "capital letter" is, however, not a most important letter but originally one that stood at the head of a sentence or word, and subsequently any letter similar in form.

[2] See Hatsfeldt and Darmesteter, Dict. gén. de la langue française, s. v. chef.

of course, the amount on which the business is started; later, it is that amount plus any additions which may have been made to it, and minus any subtractions which may have been made from it. What additions and subtractions should properly be made is constantly a matter on which opinions differ, and the rules generally accepted differ to some extent between different kinds of business and even within the same kind of business according as it is carried on by an individual or a firm or a company. But tho dispute may arise about the correct amount of the sum, there is never any doubt about its identity. Critics of the accounts may say that the sum is really greater, or that it is really less, than it is represented; they may even say that it is "all lost," while the managers assert equally confidently that it is not; but there never is any question about there being such a thing, even if it is alleged that its amount is now *nil* or a minus quantity. It is the "chief" sum because it originally started the business, and because it is ordinarily bigger than the sums obtained by means of the business — "the profits" for the short periods such as a year or half-year for which they are likely to be calculated. The kind of preëminence which it possesses is the same as that which a sum lent has over the interest upon it and which leads us to call that sum "the principal" sum, or, for short, "the principal."

My linguistic attainments are not sufficient to enable me to speak positively on the subject, and an effort I once made to enlist foreign assistance (in the *Revue d'économie politique*, May, 1893, pp. 178, 179) was a failure, but I believe that whatever was the modern equivalent of the Latin capitalis was used as a substantive to indicate this chief sum in a business in several of the Continental countries by at least the middle of the sixteenth century. The way was very probably smoothed for it by Low Latin usages; Böhm-Bawerk says, without giving any authority, that *capitalis pars debiti* meant the principal of a debt.[1] Irving Fisher[2] quotes from Du Cange's *Glossarium* "capitale dicitur bonum omne quod pos-

[1] Positive Theory of Capital, 1891, p. 24.

[2] Nature of Capital and Income, 1906, p. 62.

sidetur," i. e., "capital is a name for all the goods possessed." Anyway, the first examples of the use of capital, or rather "capitall," in this sense which have been unearthed in English literature are in books which seem to be attempting to teach the English merchant how to keep accounts with the aid of the superior methods practised abroad. Professor W. R. Scott tells us that James Peele, who taught "the art of Italian merchants accounts," writing in 1569, describes "an inventorie for trafique" as "a note to be taken in writinge of all thinges, founde and remayninge in the house apperteyninge to trade of merchaundise, thereby to know a mans estate, and doth consist of ii kinds; the one whereof, is that a man hathe or ought to have in possession, to saye in readye monie, debtes and goodes; and another kinde, is that which he oweth to other men being his creaditours, and by comparinge of the totall somme of the readye monie, debtes and goodes, with the totall somme of creaditours, the estate of that accompte is presentlye perceyved (that is to saye) so muche as the monye debtes and goodes sormounte the creaditours, so muche apperteyneth to the owner of that accompte for his proper stocke or capitall, in traffique."[1] Murray's *New English Dictionary*, the *Oxford Dictionary* or *N. E. D.*, gives from the *Briefe Instr.* of J. Mellin (a writer about whom I have not yet ascertained anything) published in 1588 "The remaine is the net rest substance or capitall of the owner." Richard Dafforne, on whom the effect of foreign influence is sufficiently suggested by his giving his examples in guilders, in *The Merchant's Mirrour; or Directions for the perfect ordering and keeping of his accounts*, 1635, gives this instruction: "No. 96. to booke the capitall which each partner of a joint company promiseth to bring in:

Simon Sands promiseth into the company for his stocke, ...	gl. 11,400
And Richard Rakes for his stocke intendeth, .	gl. 7,800
	gl. 19,200"

[1] The Pathwaye to Perfectnes, in th' accompte of debitour and creaditour; in manner of a Dialogue, very pleasaunte and profitable for Merchauntes; quoted in Scott's Constitution and Finance of English, Scottish and Irish Joint Stock Companies to 1720, vol. i, p. 61, 1912.

The *Oxford Dictionary* quotes Cotgrave's *Dictionarie of the French and English Tongue*, 1611, as negative evidence suggesting that capital was not at that date in familiar use in England, since Cotgrave, who was by no means superior to the common lexicographer's practise of translating a word by itself (as riche by "rich," généralité by "generality," large by "large"), does not say that the French capital is "capital," but "wealth, worth, a man's principall or chiefe substance." He gives as an example of its use, "en argent soit le capital de celuy la qui te veut mal. Prov. Let money be thy enemies whole stocke."[1]

Three years after Cotgrave's *Dictionary* was published, capital, we are told by Professor W. R. Scott, began to be used in the records of the East India company to indicate what we should now call the nominal amount of the holding of a shareholder, not "in the company," for the company had not yet arrived at the stage of having a permanent stock or capital, but in one of the undertakings called a "voyage." When the shareholders in one of these "voyages" were to receive a sum equal to 50 per cent on their holdings, on September 20, 1614, the records call this a division of "fifty on the hundred," but on December 6 they call it a division of a "half-capital," and a fortnight later they speak of "capital in money" being divided where we should speak of a dividend of 100 per cent. "After 1614," says Professor Scott, "payments expressed in terms of one or more 'capitals' are frequent." Here the term "capital" is used, just as in the example quoted above from Dafforne, for the capital subscribed by the shareholder (or held by him if he has obtained his shares otherwise than by being an original subscriber). Moreover in

[1] Those who consult the Oxford Dictionary should make themselves acquainted with the symbols it employs. Several good writers, failing in this, have imagined Cotgrave's to be a dictionary of English, and have therefore quoted his translation of the French word capital as if it were a definition of the English word capital. They would have avoided this error if they had noticed that the quotation from Cotgrave is preceded by the symbol intended to indicate negative evidence; the N.E.D. quotes Cotgrave's translation to show that capital was *not* familiar to lexicographers as an English word in 1611. This negative evidence may be supplemented. The 1632 edition of Cotgrave's work has an English-French part which gives "Capitall, capital, capitulaire, a great capitall (or text) letter, cadeau." And Henry Hexham's copious English and Nether duytch Dictionarie, 1660, gives Capitael, The Principle or Chief Summe.

1621 an English translation of Orders of the States-General of the United Provinces for the establishment of a West Indian Company mentions the "capital or stock" of the members of the company and the "capital sums" subscribed into the company by them. Professor Scott thinks that the new term was introduced because the "stock" of the company in the sense of the things which it possessed included what it had bought with borrowed money, so that when it was expressed in terms of money the total stock of the company would be what was subscribed by the shareholders plus what was borrowed, and therefore a division of fifty on the hundred (or, as we should say, 50 per cent) "on the stock" might be misunderstood. It is clear that the various significations of "stock" in connection with companies would require to be distinguished somehow, and the rather exotic "capital" was called in for the purpose.

From calling the holdings of the individual members of a company, when thought of as amounts of money, their "capitals," it is a very short step to calling the aggregate of these holdings "the capital of the company"; a short step which is made easier by the fact that this aggregate is the thing upon which all operations of the company are founded — it is the most important or chief stock of the company. We can almost see the working of the seventeenth-century mind in this matter in the Bank of England's 1697 act of Parliament (8 & 9 W. & M., chap. 20). Sect. 20 first wedges the adjective "capital" in between "common" and "principal," speaking of the "common" capital, and "principal" stock of the company, and then drops both "common" and "principal" by referring to the same thing as "the said capital stock." The term "common" suggests the idea of aggregating the individual "capitals," and "principal" suggests the idea of the preëminence of the particular stock.[1]

The Act shows that the idea of the capital of the company as a sum of money with nothing but an historical connection

[1] As there are no commas in the original, the word "capital" in "common capital and principal stock" might be taken to be a substantive, but this interpretation seems excluded by the use of "capital stock," and would make no difference to the argument above if it were adopted.

with the actual possessions of the company at the moment had as yet made little progress, since "for the better settling and adjusting the right and property of each member" of the company, the capital stock was to "be computed and estimated by the principal and interest owing to them from the king or any others and by cash or by any other effects whereof the said capital stock shall then really consist over and above the value of the debts which they shall owe at the same time." The idea evidently is that the "real" capital stock is the assets less liabilities, not the sum originally subscribed plus additions and minus subtractions made in some formal manner. But we may safely say that in the region of company finance capital was fairly established by the end of the seventeenth century in the two senses in which it is still understood there. When the company started, and shareholders provided the money, they were said to provide "capital," and this, once obtained, became the "capital stock," or shortly "the capital" of the company, and was the sum on which profits were reckoned and dividends declared at so much per cent, its ownership being regarded as distributed among the members or shareholders in proportion to the number of pounds held by each of them.[1]

Starting thus in company finance, the term gradually won its way into the fields of individual finance, "political arithmetic," and economics.

In earlier times the individual could feel no want of such a term in his own affairs. The primitive agriculturist, feeding himself and his family almost entirely on what he and they have won from the ground with their own hands, might recognize, like Abraham and Lot, that his stock of cattle had increased, or that he had got his soil into better condition, but he certainly never dreamt of saying that he had put a certain number of shekels or pounds into the business and was getting 10 per cent or any other percentage upon that number. The

[1] I am not forgetting that companies' capitals are often divided into shares, that dividends are declared at so much per share, and that each member is regarded as holding a number of shares. In fact the shares are always described as "–pound shares," and the holder of a £10 or £1 share is in just the same position as the holder of £10 or £1 of "stock" in a company which does not allow division below £10 or £1.

early artisan knew when his stock of tools was improving or deteriorating and when his stock of materials or finished goods was greater or less, but it did not occur to him that he ought to know what profit he was making on the sum of money which he had — very gradually in all probability — "put into the business."

But by the time the term capital came into general use in connection with companies, there were many individuals, chiefly merchants, who could make some estimate of the amount of money embarked in their business, and who would find it convenient to calculate what percentage upon that amount they were making, inasmuch as the percentage would tell them whether they were doing well or ill compared with their neighbors at the same time, and compared with themselves in earlier periods, and also whether it would be better to drop the particular line of business and take up some other. "Stock" was not a very convenient term for the amount of money put into the business, since it properly signified the actual things owned, tho sometimes used of the money put into them. A man's "stock-in-trade" would be that part of his goods which was used in his trade, but what was wanted was a name for the amount of money invested in this stock-in-trade. It was very naturally found in the term which had come into use for the amount invested in the stock-in-trade of a company, and men began to talk of "putting capital into" their own individual business just as they spoke of putting capital into such and such a company.

So Postlethwayt's *Universal Dictionary of Trade and Commerce* in 1751 gives us this:

"Capital, amongst merchants, bankers, and traders, signifies the sum of money which individuals bring to make up the common stock of a partnership when it is first formed. It is also said of the stock which a merchant at first puts into trade, for his account. It signifies likewise the fund of a trading company or corporation, in which sense the word stock is generally added to it. Thus, we say the capital stock of the bank, &c. The word capital is opposed to that of profit or gain, though the profit often increases the capital,

and becomes itself part of the capital, when joined with the former."

Johnson, whose attitude towards finance is shown by his explaining "stockjobber" as "a low wretch who gets money by buying and selling shares in the funds" had not got so far in 1755 as to recognize capital as a substantive at all. "Capital Stock" he explains as "The principal or original stock of a trading company."

Postlethwayt thinks of the merchants capital as the stock, by which he evidently means money, first put into his trade. There is something prior and something subsequent to this. Before the merchant first puts the sum into trade it is there ready to be put in. The merchant "has capital to employ." When he has put it in it does not cease to exist; he still has capital unless it is lost, which normally it will not be. The term was already used of money to invest. After being once put in, the merchant's capital would be analogous to the capital of the company, with this very important exception, that there was no need to stereotype it in the same way.

In company finance it is convenient that the capital should have a great measure of fixity. It may indeed from time to time be increased by the addition of new subscriptions or formal appropriations from profits, or be decreased by some rather solemn process of "writing down." But the whole or most of the convenience which is obtained from the use of the conception would be lost if the capital was continually varying with every fluctuation in the money value of the stock in trade and goodwill owned by the company minus its liabilities. Imagine the confusion which would be wrought in the payment of dividends in stock exchange dealings and elsewhere if the capital of every bank and railroad were adjusted every six months or even every year on the principle of the 1697 act of Parliament! The capital of the company, sometimes called even now the "nominal capital" owing to the continuance of a hankering after a "real capital," cannot be frequently altered without inconvenience. But an individual has no such need for a "nominal capital," because he has no stock or shares to be dealt in, and no shareholders among

whom profits are to be divided. Consequently he is more likely to think of the capital in his business as the money value of the stock-in-trade and goodwill of the business at the moment when the accounts are made up. If it is less than it was last time the accounts were made up the capital in the business is less by the amount of the difference and *vice versa*. Thus the capital of the merchant or manufacturer came to mean, not, like the capital of the company, a stereotyped figure having some historical connection with the amount of money originally invested, but the money value at the moment of the stock-in-trade and goodwill less debts; or shortly the assets less the liabilities.

I do not think any one in the eighteenth century proposed to extend the conception of the capital of the merchant or manufacturer so as to make it cover the whole of his assets less the whole of his liabilities as a man. It was confined to so much of his assets and liabilities as belongs or appertains to that side of him which is merchant or manufacturer. When a company is formed to carry on a business, the question here involved cannot be asked with regard to it. The funds which it employs in its business are necessarily separated from the rest of the property of its individual members. It is true that the separation disappears if the company is one with "unlimited liability" and is insolvent. But all the more important of the old companies, like all modern companies, had limited liability; and after all solvency is more usual and normal than insolvency. So the capital of a company was never difficult to distinguish from other property owned by its proprietors. But when an individual carries on business on his own account, there is no corresponding distinction of ownership between property belonging to his business and property outside that business. All is his, and all is liable for all his debts; misfortune in business may deprive him of his furniture and dwelling-house, and extravagance in living may ruin his business by depriving it of necessary funds. Some of his material possessions may be used partly for his business and partly for the comfortable maintenance of himself and his family; his house may be partly a workshop or a "front shop,"

his carriage or cart and horse may sometimes be employed in the business and sometimes otherwise.

The difficulty may require different solutions according to the purpose in view, but it is always possible in some way or other to distinguish the capital in the business from the rest of the man's property. If, for example, the purpose is to discover how much, if anything, the man will lose by abandoning his business, we may divide his house between its two uses by asking how much a house to live in would cost him if he retired from business, subtract this from the selling value of his present dwelling and shop house, and say the remainder is capital in the business. For answering questions about the success of the business some estimate of the capital employed in it is necessary and can be made, tho often with considerable doubt.

The question, often discussed in recent years, whether land "is to be included in capital," did not present itself so long as capital was thought of as money to invest or as money which had been invested. A capital of £10,000 might be invested in the purchase of land as well as in the purchase of other movable commodities; no one would think of then reducing its amount to £8,000 if £2,000 of it had been spent on buying land. In the case of a company the semi-stereotyped figure of its capital would be unaffected by any subsequent change in the value of the land bought; in the case of an individual revaluing his possessions from time to time changes in the value of the land included in them would be either ignored or recognized just like changes in the value of other things — sometimes the land would be put "at cost" and sometimes at market value. We must remember that the capital was always conceived as the money invested, not as the things themselves in which the money was invested.

As for the application of the term to the affairs of the nation, at least two pre-Smithian writers, and probably others, summed up a total which they regarded as the national capital. The author of a *Discourse of Money*, 1696, p. 198, talks of "the capital stock of national treasure," and Andrew Hooke, in his *Essay on the National Debt and National Capital*,

1750, treats the "national capital" as consisting of (1) "cash, stock, or coin," (2) "personal stock" or "wrought plate & bullion, jewels, rings, furniture, apparel, shipping, stock-in-trade, stock for consumption, and live-stock of capital," and (3) "land stock," "the value of all the lands in the kingdom."

Such was the situation when Adam Smith took the term in hand. In the student's notes of his *Lectures* it only occurs on p. 248, where it is used simply of a sum of money lent as opposed to the interest paid on the loan. "When a sum of money is lent to a private person, the creditor can come upon the debtor when he pleases for both capital and interest; but it is not on this footing that the government borrows money; they give you a right to perpetual annuity of 3 or 4 per cent, but not to re-demand your capital." Such anticipation of the doctrine of the *Wealth of Nations* as can be found in the *Lectures* must be looked for in the passages which deal with "Stock." Bounties are condemned because "in every country there is in store a stock of food, clothes, and lodging," and the "number of people that are employed must be in proportion to it," so that if bounties are given to one trade, stock and employment are simply taken away from the rest (p. 181). One of the great causes of the "slow progress of opulence" is the difficulty of accumulating stock, which is necessary before labour can be divided, since "a poor man with no stock can never begin a manufacture" and "before a man can commence farmer, he must at least have laid in a year's provision, because he does not receive the fruits of his labour till the end of the season," so that "in a nation of hunters and shepherds no person can quit the common trade in which he is employed" — presumably hunting or tending sheep — "and which affords him daily subsistence, till he have some stock to maintain him and begin the new trade." The savage with "no stock to begin upon" and "not so much as a pick-axe, a spade, or a shovel" to assist him, finds the very greatest difficulty in getting together any stock, and "till some stock be produced there can be no division of labour, and before a division of labour take place there can be very little accumulation of stock" (pp. 222, 223).

Want of security against internal disorder and external attack forms another hindrance to accumulation. Taxes on land are distinguished from taxes on stock, and a tax on stock is condemned because it requires discovery of "what a man is worth," so that presumably we must understand a man's stock to include all his possessions other than land.

In Book 1 of the *Wealth of Nations* we hear very little of "capital," while "stock" is playing the same important part as in the *Lectures*. It is still the "profits of stock," not "of capital," which is one of the three "component parts of price" and one of the three "original sources of all revenue" (p. 54). Chap. 9 is "Of the Profits of Stock." Except, I think, on one page where "the capital stock of the society" and "the capital stock of Great Britain" suddenly appear as synonyms for "the stock of the country" (p. 95), "capital" is only used in relation to individual businesses. But the physiocrats' talk of "advances" and "capitaux" and their doctrine of productive and sterile labor seem to have made Smith look further into the nature of stock, with the result that in Book 2, "Of the Nature, Accumulation, and Employment of Stock," he divides the stock of an individual and of a community into two parts, the "capital" and the "stock reserved for immediate consumption." This indicates a very serious departure from the conception of capital which had hitherto prevailed. Instead of making the capital a sum of money which is to be invested, or which has been invested in certain things, Smith makes it the things themselves. Instead of being a sum of money expended on the acquisition of stock, it is part of the stock itself. But the change is not pointed out to the reader in any way, and Smith was doubtless quite unconscious of having made it. He constantly drifts back into expressions which are only appropriate to the older conception. Immediately after making the division of stock into capital and not-capital he says that "a capital" may be "employed in raising, manufacturing, or purchasing goods and selling them again with a profit." Or "it may be employed in the improvement of land, in the purchase of useful machines and instruments of trade, or in such like things as

yield a revenue or profit without changing masters," which is just what might be said by anyone with the old and still ordinary conception of capital as money which is to be invested or has been invested. Similarly a little lower down, the "price or value" of the farmer's laboring cattle and instruments and "the whole value of the seed" appear a part of the farmer's capital, altho in the same paragraph the things "a flock of sheep or a herd of cattle" are treated as themselves the capital.

If Smith had recognized that the new sense nearly equivalent to "stock-in-trade," which he was attributing to capital, was different from the old well-established sense, it is doubtful whether he would have persisted, and it is certain that if he had either not made the change or had explained clearly that he was making it, much subsequent confusion would have been avoided. But that is another story which cannot be dealt with in this article.

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EARNING POWER AS A BASIS OF CORPORATE CAPITALIZATION

This article is written with a definite purpose. Its object is to show that a certain widely accepted principle of corporation finance — the principle that capitalization should be based on earning capacity rather than on actual cost — is not only unsound in theory but is also vicious in its practical application. None of the points to be adduced in support of this view are original with the author. At one time or another they have all been noted implicitly or explicitly by earlier writers. Yet they have never been presented with sufficient emphasis to carry conviction, if one may judge from the fact that the "earning power basis" not only persists among recent text-book writers, but is accepted by them uncritically, without even an attempt to meet the arguments that can be urged against it.

Before considering the earning power basis, let us first note its alternatives. Two other possible bases are usually mentioned by writers: actual cost of assets, and replacement cost. To illustrate the three different possibilities, let us assume the case of a corporation whose property, save for a negligible amount of current assets, consists entirely of buildings and grounds that were purchased in 1910 at a cost of one million dollars. At the present time, in view of higher prices and appreciation in land values, the cost of replacing that property would be two million dollars. But the company is very prosperous and gives assurance of earning an average net income of $200,000 per year. Capitalizing this income at a nominal rate of interest, say 5 per cent, one arrives at four million dollars as the present value of the enterprise as a going concern. In a case like this, it makes a deal of difference which of the above three bases is to be accepted as the test of the proper amount of security issues. On the basis of actual cost, the limit is one million dollars; on the basis of replace-

ment cost, it is two million dollars; while on the basis of earning power, a capitalization of four millions is permissible.

Of course the relationship assumed in the above figures is only hypothetical. Often capitalized earning power would be less than actual cost or replacement cost. A capitalization based on an estimate of earnings is not necessarily a high capitalization; that is, it is not necessarily high in theory, altho it is almost invariably high in practise, owing to the extremely liberal estimates of earning power made by financiers.

With this introduction, let us consider the reasons that are presented in defense of the earning power basis of capitalization. All supporters of this basis use the same general line of defense, but no one has stated the case more clearly and uncompromisingly than has Lough in his volume on *Business Finance*.[1] We shall, therefore, find it convenient to analyze Lough's argument, as fairly representing the position of those who accept the earning power standard.

Lough begins his discussion by stating that "The question: 'What is the right basis of capitalization?' is almost identical with the question: 'What is the best measure of wealth?'" In other words, a company is properly capitalized when the par value of its outstanding securities corresponds roughly to the actual value of the assets that these securities represent. If we accept this position, our problem is then simple: it is to find the best measure of the value of the assets. Is this best measure original cost? Certainly not; for if a corporation can earn little or nothing for its security holders, what matters it that its physical property may have cost many millions of dollars? Aside from bare scrap value, assets are worth only what they will earn, and not what they may have cost. But if we rule out original cost, how about cost of replacement? Even this basis, according to Lough, would not be satisfactory: for it does not correctly measure value. While it may fairly indicate the value of the tangible assets, it does not take account of intangible values. "To every piece of property there attaches a certain intangible value. A man running a

[1] William H. Lough, Business Finance (New York, 1917), chap. viii.

successful retail shop would not be willing to part with it, ordinarily, in exchange for another shop which was just as well fitted up and carried the same stock but which had been unsuccessful. . . . It is possible — at least theoretically — to reproduce physical assets, but it is impossible to reproduce goodwill, organization, prestige, and the like. Hence, the attempt to measure wealth by figuring the cost of reproducing properties breaks down as soon as we begin to measure the value of intangible assets."

Following the above line of reasoning, Lough is led to conclude that the correct measure of value is earning power. "If we take into account not merely current earnings but also potential earnings, then we have here a measure of wealth which must be a true and satisfactory measure. After all, in buying property for business reasons, what do we buy? Not merely so much real estate or so many articles. We are buying income."

Lough concludes: "If the answer that earning power is the best measure of wealth is granted, and if the proposition that 'capitalization' of an enterprise is an approximate estimate of its wealth is accepted, then it would seem to follow that the correct basis of 'capitalization' is earning power. This answer, however simple and sound it may appear to us, is not a principle of the law governing corporations, which, on the contrary, assumes that investment is the only correct basis of capitalization."

The argument as stated by Lough is delightfully clear and simple, and its logic seems impregnable if we accept its two premises — (*a*) that capitalization should correspond to the actual value of the assets, and (*b*) that this value is measured by the earning capacity of the enterprise. But can we accept the premises? Let us consider first the second — that value is measured by earning power.

This, in the approximate sense in which it is meant, is doubtless correct. The fact that other factors than present or expected earnings are of influence in determining value merely qualifies without destroying the truth of the statement. But one should take careful note that if earning power is to be

accepted as a measure of value, this earning power must be estimated and capitalized at whatever figure is determined by the market. For value, in the economic sense, is simply market value. It is the valuation which the investing public places upon a particular property. In making such a valuation, the public will have its own ideas of future earning power and will capitalize those expected earnings at a rate of interest depending, among other things, on the element of risk involved. In short, if one is really serious in asserting that capitalization should represent value, one must accept the conclusion that the total par value of outstanding securities should not exceed their market value. Of course, merely to state this condition is to indicate that the advocates of the earning capacity basis do not really want to base capitalization on *value*. In practise, they would estimate future earnings at a very liberal figure, and then they would capitalize this figure, not at the market rate of interest — which would be high, owing to the great risk in a new enterprise — but rather at some conventional rate such as 5 or 6 per cent. The resulting capitalization, of course, does not represent value at all. At best it represents what the promoters hope that the value may sometime be. More likely, it is a pure fiction.

But let us overlook this discrepancy between the *theory* that capitalization should represent value, and the *practise* of issuing securities in excess of the real value. What about the theory itself — the principle that capitalization should represent the value of the assets? This assumption is stated by Lough and others without any attempt at justification. Apparently it seems to them self-evident, not even requiring to be proved to the uninitiated reader. But as a matter of fact, is it really so obvious and necessary an assumption? Is it not based rather on a disregard for some of the most fundamental principles of accounting? The fallacy in the assumption — at least what seems to the present writer to be a fallacy — lies in the failure to bear in mind that capitalization is not an asset at all, and is not even a measure of total assets. It is rather the sum of the fixed liabilities (the outstanding funded debts) and

a *certain part* of the proprietorship — capital stock. These two accounts are found on the right side of the balance sheet, and they seldom alone equal the value of the assets as noted on the left-hand side. The difference between assets and capitalization is registered in the various surplus and deficit accounts. To assume that capitalization is a measure of the value of the property is to overlook the fact that capital stock does not alone represent the total proprietorship and hence does not indicate the total net assets. What it does represent is "capital" as distinct from surplus, the capital being the amount that must be retained in the business and the surplus being the amount that may be drawn upon for dividends. Capital stock may thus be compared to a low-water point on a boiler; it no more represents the value of the assets than does the low-water point measure the actual amount of water in the boiler. It simply fixes a limit below which assets must not be distributed in dividends, a point fixed by law at the amount of capital actually contributed by the shareholders.

If those who insist that capitalization is a measure of value were really prepared to accept the logic of their position, they would be forced to hold that any material change in the value of the property should be accompanied by a corresponding change in nominal capitalization. Of course, such a position is untenable. Value, whether measured directly by stock and bond quotations or indirectly by earnings, is constantly changing with the ups and downs of the business. This year it is low; next year it may be high; the following year it may again be low. To change the par values of outstanding securities so as to make them correspond to the shifting property value would be quite out of the question from a practical standpoint, even if it were desirable in theory — which it is not. Defenders of the earning power basis recognize this difficulty and therefore do not attempt to carry their theory to its logical conclusion. Instead, they propose simply that, at the outset, an estimate of value based on earning power should be made, and that this estimate should determine once for all — or at least for a long time — the capitalization.

But this concession is fatal. For it destroys the entire force of the argument that the *value* of the property, as something distinct from the *cost*, should be taken as the basis of capitalization. It is only after a lapse of time that a discrepancy ordinarily arises between the value of assets and their costs. At the outset, sound accounting would not sanction a valuation at a higher figure than the actual costs. Only after the business has developed a goodwill or a surplus from reinvested earnings can there be adequate ground for holding that the value of the property exceeds the price that has been paid for it. Hence, the notion that value as distinct from original cost should be the basis of capitalization collapses when it is admitted that capitalization cannot be shifted to correspond to a fluctuating value. Critics of original cost as the basis of capitalization have objected to it on the ground that it soon becomes out of date — that it represents a mere historical fact instead of a present condition. In this respect, however, the earning power basis has no better claim to favor than does its rival, original cost. Indeed, the claim of the former is not so good, for whereas original cost is a historical fact of real significance, an out-of-date estimate of earning power is of little or no consequence.

It would be interesting, and perhaps illuminating, to discover how this fallacious notion that capitalization should represent the value of the assets has been accepted so uncritically by writers on corporation finance. One may conjecture that a partial explanation lies in a confusion between partnership accounts and corporation accounts. In a partnership, no distinction is made between the capital contributed directly by the partners and the surplus from reinvested earnings. Both amounts are covered in one general account on the liabilities side of the balance sheet — "proprietorship." This proprietorship, since it represents original capital plus surplus or minus deficit, is therefore an actual measure of the net assets; that is, it represents the difference between the value of the assets and the amount of the debt. But with corporate accounts it is different. Here there is no single proprietorship account. A distinction is made between capital contributed

by shareholders and surplus from reinvested earnings. It is only by adding surplus to capital, or by deducting deficit from capital, that one arrives at the net value of the corporate assets. If corporate earnings increase, if the value of the assets rises, this fact may be shown, not by a credit to capital stock, but rather by a credit to surplus. If assets decline in value, the fall is registered, in the absence of a reorganization, not by a reduction in capitalization but by a reduction of surplus.

To many practical men of affairs the foregoing objections to the earning power basis would seem hopelessly theoretical. Admitting all that has been said about the failure of this basis to square with strict accounting theory, they would hold that as a practical business matter, earning power is the only sensible measure of proper capitalization. For is it not earnings, present and prospective, that determine the value to investors of their securities? To this question the reply is that earnings certainly do largely determine the value of the shares, but that it does not follow that such a value should be registered in the nominal capitalization, in the par value of the securities. For what proper object is there in making par values represent market values, or earning power? These two items can be seen simply by noting the market quotations on the stock and the reported annual earnings of the company. It would be useless to attempt to register this market value, or to capitalize these earnings, in the form of a stated par value of the shares. And in any event the attempt is sure to be a vain one, for par values are relatively fixed, while market values and earning capacity are constantly fluctuating.

But if the earning power basis of capitalization is both unsound in theory and impracticable in application, why is it so generally supported by American financiers? The answer is fairly clear: it is that the earning power basis of capitalization gives promoters the opportunity to set the nominal capital at whatever figure they think will give the securities their highest market value. One of the strange but well recognized phenomena of the financial market is that an enterprise capitalized at a liberal figure is very apt to seem more valuable to the

investing public than would that very same enterprise if capitalized at a lower amount. The "magic of par value" often has a decided influence. American promoters are past masters in the art of taking advantage of this preference for a large nominal amount of stocks and bonds. And in this game their best ally is the highly sanctioned theory that capitalization should properly be determined by earning power. For by estimating future earnings at an extravagant figure and then by capitalizing these earnings at a very low rate, the promoters are able to justify an issue of securities far in excess of the actual cost of the property.

Of course it may be argued by supporters of the earning power basis that this inflation of capitalization beyond the reasonable value of the property condemns merely the abuse, but not the proper use, of the principle. As a practical matter, however, this defense carries little weight. It is idle to expect that promoters and bankers who are personally interested in putting a high valuation on their properties will make a conservative and impartial estimate of the earning power of their enterprise. Even when they are honest — and honesty is a relative term — they are almost sure to be overoptimistic; that is their nature. The fact is that earning power (i. e., prospective carning power) is largely a matter of conjecture. There can be no adequate objective tests. And to expect a conservative capitalization to be set up in the absence of objective tests is simply utopian.

As to those financiers who make no effort to find a theoretical defense of their methods of determining capitalization, but who more or less frankly issue whatever amounts of stock will give their holdings the best market, nothing need be said in this place. All that is here insisted upon is that such practise should not be allowed to seek shelter — as it has done in the past — under a "theory" of capitalization that is said to have the support of "sound economics." [1] Is it unfair to suggest

[1] The most recent and most carefully written treatise on corporation finance — that by Dewing — recognizes frankly the fictitious nature of nominal capitalization as it is usually determined. "The common stock," it states, "may be issued to any amount that suits the convenience of the promoters; probably the amount should be large so that a considerable number of shares can be distributed to bankers, investors, lawyers,

that those writers on corporation finance who have afforded such a shelter should hold themselves at least in some slight measure responsible for the notorious prevalence of inflation in American corporation finance? [1]

So much space has been devoted to a criticism of the earning power basis of capitalization that there is no opportunity here to discuss at length the other possible bases. The writer's position will be inferred from the very objections that he has urged against the earning power principle. Briefly it is this: since capitalization is a measure of liabilities rather than of assets, it should equal the principal of the funded debt plus the amount of capital actually subscribed for by shareholders. This is the orthodox theory. Its merit is the simple one of truthfulness, for it requires that the par value of a share shall mean just what it purports at law to mean — namely, the actual contribution made by the shareholder.

Doubtless it is often impossible for a corporation to market its shares at par. Until recently, corporations under such circumstances were probably justified in issuing "full paid" shares at a discount. But this excuse is no longer generally valid. For it is now possible, under the laws of many states, to issue shares of stock without par value and thus to avoid the necessity of marketing shares at a discount. The very fact that such a practicable alternative now exists should make governmental authorities and courts far more rigid than they have been in enforcing the liability of stockholders to make full payment for their subscriptions as represented by the par value of their shares.

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and the like, and the promoters still retain a controlling majority." Financial Policy of Corporations (1920), vol. ii, p. 60. While many will not be able to accept the principle that capitalization should be a mere fiction, they will admit that it is far better frankly to recognize its fictitious character than to maintain the pretense of a reality that does not exist.

[1] The reader may recall the defense by George Kennan of one of the most ill-advised and harmful cases of stock watering, the Chicago & Alton recapitalization of 1899–1900. Mr. Kennan bases his case in large measure on an attempt to prove that the proper test of capitalization is not actual cost but earning power. In support of this position he cites the opinion of eminent authorities in the field of finance. Kennan, The Chicago & Alton Case: A Misunderstood Transaction (1916), pp. 28–34.

WILLIAM BENBOW AND THE ORIGIN OF THE GENERAL STRIKE

Recent scholarship has shown that the idea of the general strike as a means to political revolution did not originate with French syndicalism, but arose as an incident in the bitter struggle of the British workingman for economic and political power, during the Chartist period.[1] It has been established that the concept held an important place in Chartist ideology and, under the titles of the "Sacred Month" or "National Holiday," became for a time the central feature of the movement. The origin of the idea has generally been associated with one William Benbow.[2] A consideration of the very scanty biographical material available concerning Benbow is of interest, both because it throws some light upon an important if obscure actor in the events of that period, and because it gives a basis for estimating the extent to which he may be considered the real originator of the general strike idea.

William Benbow was born in 1784,[3] probably somewhere in the vicinity of Manchester.[4] At the age of twenty-four he had established himself as a non-conformist preacher,[5] apparently of the Quaker sect,[6] at Newton, a suburb of Man-

[1] It was apparently introduced to French workingmen by some English delegates to a congress of the First Internationale in 1866. Saulière, La Grève Générale de Robert Owen, Bordeaux, 1913, p. 16.

[2] Cf. Beer, History of British Socialism, London, 1920, vol. i, pp. 314–318; vol. ii, pp. 81 ff. West, History of the Chartist Movement, New York, 1920, pp. 68–70; Hovell, The Chartist Movement, London, 1918, pp. 138 and 164, 165; Russel, Proposed Roads to Freedom, New York, 1919, p. 71, footnote. Beer's account is the most adequate, and has been largely drawn upon in this note.

[3] He was 56 years old when condemned for sedition at Chester in 1840. H. O. Assises Book, 61/9 (Chester), April 10, 1840.

[4] He was in a suburb of Manchester in 1808 (cf. next note), and was in Manchester in 1817. Beer conjectures that he was born in London.

[5] He was preaching in a chapel at Newton when the roof of the parish church "fell in with a tremendous crash." Benbow, Crimes of the Clergy, London, 1823, p. 80. According to the History of Newton Chapelry, this event occurred on Sunday, May 1, 1808.

[6] He uses the Quaker idiom of "not holding communion with" a disreputable character, Benbow, loc. cit.; addresses his wife in a letter as "Thee," Benbow, Censorship

chester. It is probable that he was then earning a part of his living as a shoemaker; at all events this was the occupation he gave as his calling toward the end of his life.[1] By 1817 he had moved to Manchester, and had married. He was by this time an active worker in the radical movements then agitating northern England. He attended a meeting in the "Crown and Anchor" in London, as a "delegate"[2] and — according to the evidence of a government spy — was engaged in the manufacture and sale of pikes for use during armed insurrection.[3] During the excitement following the collapse of the so-called "Manchester Insurrection," and preceding the abortive Nottingham uprising, Benbow was arrested. Apparently the machinations of government spies, similar to those carried on by the notorious "Oliver," were partially responsible for Benbow's misfortune.[4] Benbow was taken to the Cold Bath Fields House of Correction in London, where, after an interview with Lord Sidmouth, in which the Home Secretary promised him a "fair trial," he was confined for several months. Eventually, he was (presumably) tried and released, perhaps under the pressure brought upon the authorities by the revelations concerning the government spy system, which had intervened between Benbow's arrest and release.[5]

Shortly after his return to Manchester, Benbow put out his first publication — a pamphlet entitled, *Censorship Exposed.*[6] Besides two more or less personal letters to his wife, Benbow put in his pamphlet a long letter to Lord Sidmouth,

Exposed, Manchester, 1817, p. 6; and expresses strong abhorrence of war, Benbow, Crimes of the Clergy, pp. 224, 225.

[1] He was entered in the prison records as a shoemaker on the occasion of his third imprisonment. Accounts and Papers, Gaols and Prisons, London, 1840, vol. xxxviii, No. 600, p. 690.

[2] Hovell, op. cit., p. 91, footnote.

[3] Ibid., p. 136. The manufacture and sale of pikes to revolutionarily inclined workingmen was apparently an extensive and lucrative business during this period. Cf. General Napier's observations, quoted in West, op. cit., p. 129.

[4] Hammond, The Skilled Labourer, London, 1919, pp. 350–362.

[5] Benbow, Censorship Exposed, passim; Hammond, op. cit., pp. 359–371.

[6] The subtitle is "Letters Addressed to R. H. V. Sidmouth and Mrs. Benbow." The writer is indebted to Mr. G. D. H. Cole for a suggestion which led to the discovery of this pamphlet.

all dealing with the circumstances of his imprisonment, and all containing high-flown, rambling tirades against "tyranny" and "despotism." The grammar and spelling are crude, suggesting the work of a self-educated workman; but there is a remarkable vehemence and forcefulness, and a surprising richness of metaphor and allusion. The crudities drop out in later writings, while the good features of the style are further developed; the disjointed, unrestrained character, however, remains through all of Benbow's writing.[1]

Apparently, the rigorous repressive policy pursued by the Liverpool Ministry damped the ardor of Benbow, as of others, for political "reform,"[2] and he turned his energies to another field of agitation, in a place where his former associations might not be known. The new scene of his endeavors was London, where, about 1821,[3] he undertook the serial publication of a large number of scandal-mongering anecdotes directed against the Church of England. Benbow himself published the work as a bound volume in 1823,[4] adding an appendix presenting a detailed tabulation of "plural" livings of established clergymen in Ireland, which must have taken a prodigious amount of work, and certainly not a little ability.[5] Whether for his utterances against the clergy or for some other reason, Benbow went to prison for a second time in 1821.[6]

The book bears the inscription of "Benbow, Printer and Publisher, Byron's Head, Castle Street, Leicester Square"; and a contemporary directory indicates that Benbow was a

[1] See question raised as to Benbow's complete sanity, below.

[2] Cf. Cross, History of England and Greater Britain, New York, 1914, pp. 869–872.

[3] One "article" is dated from King's Bench Prison, May 7, 1821.

[4] The evidence that it was serially published is inferential: different parts of the work are referred to as "articles"; the British Museum copy consists of different grades and sizes of paper.

[5] The author claims to have prepared it at the request of a member of Parliament, "who expressed the greatest anxiety to become qualified to bring the question before the House." He also speaks of a similar "simple equation of tithes" for livings of clergymen in England, prepared in 1817 possibly during his first imprisonment.

[6] Cf. third note above. Also Notes and Queries, London, 1876, 5th series, vol. vi, p. 329. That the imprisonment was probably due to Benbow's anti-clerical activities is suggested by the statement in the "Address" constituting a preface to the Crimes of the Clergy, that "We have suffered deeply from church oppression . . . and our person has been thrown into a dungeon."

bookseller as well as a publisher.[1] Other publications brought out by him from the "Byron's Head" included a reprint of Byron's "Don Juan,"[2] a number of "religious tracts" and a "periodical work in defense of the state,"[3] as well as parts of an unauthorized edition of Southey's revolutionary poem, "Wat Tyler."[4] The latter prompted a virulent open letter from Southey, directed at Benbow, in which his book-shop is called "one of those preparatory schools for the brothel and the gallows, where obscenity, sedition, and blasphemy are retailed in drams for the vulgar."[5] Benbow's next work, *A Scourge for the Laureate*, is a pamphlet issued in reply to Southey's attack, and is relatively restrained and dignified. The author sarcastically reminds Southey of his "apostasy" from the revolutionary fervor of his "Wat Tyler" to the lucrative conservatism of the laureateship; he also takes pains to insist upon his devotion to religion.

Benbow's next publication was his *Grand National Holiday*, in which his theory of the general strike was promulgated. It was published early in 1832.[6] There is uncertainty concerning the circumstances of Benbow's life at this time, but it is probable that he was supporting himself as a shoemaker,[7] and lodging-house keeper,[8] while giving a generous proportion of his time to agitation. It is possible that he was for a while proprietor of a Fleet Street coffee house.[9] What-

[1] Piggot's London Commercial Directory, London, 1823–24.

[2] London, 1822.

[3] Benbow, A Scourge for the Laureate, London, 1825 (?), pp. 16, 17.

[4] With William Carlile, according to Beer, op. cit., p. 315. The British Museum contains a copy of the poem published by Carlile about this time, but no reference to Benbow appears on its title pages.

[5] The letter appeared in the Courier for December 13, 1824, and is reprinted in part in Benbow, loc. cit.

[6] "This day is published, price 2*d*, Benbow's Grand National Holiday," Poor Man's Guardian, January 28, 1832.

[7] What seems to be a reprint of his Grand National Holiday, is advertised in the Poor Man's Guardian for May 17, 1834, as "by a Journeyman Bootmaker."

[8] "All the lodgers' beds" were taken by a "taxgatherer." Tribune of the People, June 24, 1832.

[9] This is the conclusion drawn by Beer, op. cit., p. 315, and by West, op. cit., p. 68, from the fact that the Grand National Holiday is written from "The Commercial Coffee House, 205 Fleet Street," but, in view of the fact that the Tribune of the People, published by Benbow later in the same year, is published from "The Institute on Theobald's Road," this evidence is not conclusive. It should be remembered that, as early as 1664, it was the practice to address matter for publication from one or another coffee

ever his occupation, he was one of the most radical and most influential members of the National Union of Workingmen, called by Beer "the birthplace of Chartism." [1] This organization, commonly called the Rotundanists, used to gather about one thousand strong in the "Rotunda" in Blackfriars Bridge Road, where they passed resolutions on various topics, and tumultuously cheered harangues by Benbow and "certain other more or less disreputable revolutionists." [2] In this forum Benbow spoke, sometimes as chairman, more often as sponsor or as seconder of a motion or resolution, at great length and with great discursiveness.[3] He almost always, however, took occasion first, to express impatience with dependence upon political reform, especially the Reform Bill — thus anticipating the present-day "direct action" school; second, more or less openly to advocate "resistance," even to the point of urging military organization and drill; [4] and, third, to mention repeatedly his project of a "national convention" and "national holiday." [5]

Benbow did not confine himself to revolutionary talk. On one occasion he "laid in a stock of heavy constables' staves, which he retailed at a few pence each to such members as desired to protect themselves against the police," in antici-

house (Robinson, English Coffee Houses, London, 1893, p. 143), while Addison and Steele somewhat later pursued the same practice. (Cf. Tattler, No. 1.) That the "Commercial" would be an appropriate establishment from which to address a work of this kind is suggested by the fact that a dinner commemorating the birthday of Thomas Paine was held there in February, 1832, Poor Man's Guardian, February 7, 1832.

[1] Beer, op. cit., p. 299.

[2] Wallas, Life of Francis Place, revised edition, New York, 1918, pp. 272–274. Place pronounced them "loud and long talkers, vehement, resolute, reckless rascals."

[3] The Poor Man's Guardian reports twenty-two speeches between September 3, 1831 and February 2, 1833.

[4] Under the disguise of "classes," modeled on the "Weslyan" plan. He invited, indeed, old soldiers to join the "classes," and urged them to "teach their brethren military evolutions." Poor Man's Guardian, November 26, 1831.

[5] In one speech he seconded a motion calling for the liquidation of the Bank of England, and also took occasion to condemn the "funding system"; to state "that some of the autocracy had drawn immense sums out of the Bank and sent them abroad in case they might be driven from this country"; to accuse Wellington of being "half willing" to use the military "to put down the Unions, but let him try it"; to accuse Wellington of plotting with Metternich to import foreign soldiers "to dragoon us," and perhaps to burn London "like Moscow"; to express fear of soon being "immured in a dungeon"; to refer to "a General Congress of the People," and finally to close, amid "cheers," with a fervent appeal "to go forward in the common cause of 'Equal Rights and Equal Laws.'" Poor Man's Guardian, May 19, 1832.

pation of a demonstration which was postponed because of extensive counter preparations by the authorities.[1] On another occasion, he participated in a procession of 100,000 men, intended apparently as a sort of dress rehearsal for the "National Holiday." The parade clashed with the police, and Benbow suffered his third arrest, being acquitted, however, soon after.[2] By this time, he had achieved such notoriety as to be awarded a place in the columns of *Punch*, where he was called "mighty Benbow." [3]

For a time, Benbow entered the field of "radical" journalism, becoming editor and publisher of the *Tribune of the People*, which was to take up "a list of the principal subjects to be discussed and settled during our Congress," that is, the "Congress" which was to accompany the "National Holiday." [4] The paper seems to have run through only three issues, during June and July, 1832, and then to have been discontinued for financial reasons.[5] The material of the publication hardly fits with the promises made, and does not seem to vary materially from that appearing in other "radical" papers of the time. One article entitled "On the Right of Arming Oneself," and an editorial remark that the "Theobald's Road Institution promises fair to supersede the old dying Institution of St. Stephen's," serve to indicate the extremely revolutionary bent of Benbow's mind at the time.[6]

During this period, he had not altogether given up his vocation as a preacher, one sermon at least having been preached by him at the "Theobald's Road Institution." [7]

[1] Wallas, op. cit., p. 285.

[2] London Chronicle, March 22, 1832; Poor Man's Guardian, May 19, 1832.

[3] Quoted in Poor Man's Guardian, April 14, 1832.
"Shadows this day have struck more terrors to the mind of Melbourne
Than could the substance of ten thousand traitors
All armed with pikes, and led by mighty Benbow!"

[4] Benbow, Grand National Holiday, London, 1832, p. 15.

[5] June 17 and 24, and July 1. The Poor Man's Guardian for July 28, 1832 contains an advertisement signed by one R. E. Lee, accusing Benbow of having "victimised" Lee and of having resorted to "open robbery" in connection with his printing of the Tribune for Benbow. Lee announces a forthcoming pamphlet entitled "Benbowism Unmasked."

[6] Tribune of the People, July 1 and June 17, 1832.

[7] Ibid., June 17, 1832, "On Sunday Evening, Mr. Benbow will preach a sermon."

As has been said, it was in the midst of these activities that Benbow published his *Grand National Holiday and Congress of the Productive Classes*. The contents of this remarkable document have been ably summarized elsewhere,[1] and require only slight mention here. Briefly, it proposes that the working people declare a month's "holiday," supporting themselves from their savings the first week, but subsisting the remainder of the time by taking over parish funds, and by extorting "contributions" of money and food from the wealthy. It further proposes that local committees be appointed to maintain order and administer the distribution of food, and also to elect representatives to a national "congress" which is to "reform society." In modern terms, the people are to declare a general strike, expropriate property, and establish a new social order by means of a proletarian dictatorship.[2]

The height of Benbow's power and popularity seems to have coincided with the months following the publication of his pamphlet. In the face of the disillusionment following the passage of the Reform Bill, the National Union of Workingmen rapidly lost prestige, and tho Benbow had never been optimistic concerning the measure, he seems to have suffered eclipse with his fellow "Rotundanists."[3] For a time, he was established as a "fruiterer."[4] Then after six years, he reappeared to play a minor part in the Chartist collapse to which his own ideas had largely contributed. Their faith in political action having been destroyed by the failure of Parliamentary reform and of the National Petition, the Chartist rank and file were more than ready to listen to the "physical force men"; the workmen in the North and Midlands were in a particularly rebellious mood.[5] Benbow's project for a National Holiday was discussed and ultimately adopted by the Chartist Convention. Apparently thinking the time ripe

[1] Beer, op. cit., pp. 316–318.

[2] That there was a clear "class war" doctrine in everything but name is patent in the literature of the time. Cf. Beer, op. cit., pp. 332–334; Wallas, op. cit., pp. 273, 274. Cf. also, Benbow, op. cit., pp. 1–8.

[3] Beer, op. cit., p. 320.

[4] Robson's London Directory for 1837.

[5] Hovell, op. cit., pp. 143 ff.

personally to advocate the adoption of his project, Benbow returned to the neighborhood of his youth, and traveled about in the vicinity of Manchester, "with horse and cart, holding open-air meetings, and pushing the sale of his pamphlet on the general strike." [1]

He was arrested on August 4, 1839, eight days before the date set for the "sacred month," and two days before the Convention lost courage and voted to "implore all our brother Chartists to abandon the project of a sacred month." [2] Eight months later, he was brought to trial for sedition at the assizes in Chester, found guilty, and sentenced to sixteen months imprisonment. Tho now fifty-six years of age, he does not seem to have lost any of his oratorical vigor, for he "entered on his defence at 11.40 & finished his speech at 10 o'clock P.M." The minute book of the assizes bears evidence that, possibly through his plea, or his advanced age, he moved the court to momentary clemency, for the record of the trial closes with the notation, "To enter into Recognisance," crossed out with a heavy red-ink line.[3]

Benbow faded out rapidly from the Chartist movement after this event. In 1840, apparently while still in prison, he sent to a meeting in Manchester a scheme for the reorganization of the movement which was "too long to be read," [4] and, in April, 1841, on the eve of the expiration of his prison sentence, he appeared on Feargus O'Connor's list of the Chartists who "could be trusted." [5] No further information is available concerning him. It has been suggested that the vicissitudes of his life, and especially the strain of his self-tutelage, served gradually to unbalance a never wholly stable mind.[6] If this conjecture is correct, it is likely that the disappointment following the collapse of the sacred month, together with the rigorous treatment which he, as a Chartist,

1 Beer, op. cit., vol. ii, p. 83. West suggests that Benbow had reëstablished himself as a shoemaker in Manchester, but gives no authority for his statement. West, op. cit., p. 137.

2 Beer, op. cit., vol. ii, pp. 83 and 87.

3 H. O. Assizes Book, 61/9 (Chester), April 10, 1840.

4 Hovell, op. cit., p. 196.

5 Beer, op. cit., p. 314.

6 Ibid., p. 223.

would have received in prison [1] served to incapacitate him for further activity.

There remains to be considered the question as to how completely Benbow can be considered author of the general strike idea. Definite conclusions are impossible in the present imperfect state of knowledge concerning the man and his period. One point is, however, certain, namely, that a vague notion of a general strike as an aid to insurrection antedates Benbow's pamphlet by several years, going back to the days of the "Manchester Insurrection" and the Nottingham uprising.[2] The idea, however, seems to have remained nebulous and unheeded till Benbow (who, through his connection with these events, must certainly have noticed it) perceived its tremendous potentialities, and put it into the form which, except for phraseology, it retains substantially to this day.

One further point is of interest. The Sacred Month idea in Benbow's *National Holiday* is derived from an elaborate parallel drawn by the author of the pamphlet between his scheme and the ancient Jewish Sabbatical and Jubilee years.[3] As the Jubilee year involves such revolutionary proposals as the forgiving of debts and the nationalization and redistribution of land, the connection between the scriptural custom and Benbow's scheme is not so far-fetched as may at first seem. Furthermore, Benbow was a deeply religious man, and lived in a time when the Bible was looked to for literal guidance in current problems. It may be, therefore, that the development which this hitherto unnoticed idea reached in Benbow's fertile if ill-balanced mind seemed to him divinely sanctioned; so that the ardent persistence with which he advocated it was that of a religious fanatic as well as of a political and industrial agitator.[4]

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[1] Cf. Rosenblatt, The Chartist Movement, New York, 1916, p. 205; West, op. cit., p. 138.

[2] Hammond, op. cit., p. 358. The words "general strike" were used at this time.

[3] Benbow, op. cit., pp. 8, 9. Cf. Leviticus, xxv.

[4] Cf. in this connection, Casamian, Le Roman Social en Angleterre, Paris, 1903, pp. 199, 200, and Rose, The Rise of Democracy, London, 1897, p. 45.

THE LINCOLN TARIFF MYTH FINALLY DISPOSED OF

In two notes published in this Journal, one in August, 1914, entitled "Abraham Lincoln on the Tariff: A Myth," and the other in February, 1915, entitled "Lincoln and the Tariff: A Sequel," I presented the results of an inquiry on the origin of a phrase about the tariff ascribed to Lincoln.[1] The phrase appeared in various forms. The familiar one was this: "If we purchase a ton of steel rails from England for twenty dollars, then we have the rails and England the money. But if we buy a ton of steel rails from an American for twenty-five dollars, then America has the rails and the money both." My conclusion, after following up various clues, was that the phrase originated with Robert G. Ingersoll. Tho it did not appear in Ingersoll's published writings until after the date of first ascription to Lincoln, the evidence indicated that it had been used by Ingersoll in his orations and lyceum speeches in such a way as to lead reporters, quite without design on Ingersoll's part, to attribute it to Lincoln.

Complete confirmation of this surmise has recently come to me through the obliging inquiries of Mr. Edward F. O'Neil of New York. Endeavors of my own to secure information from members of Ingersoll's family had been fruitless. Mr. O'Neil, however, has communicated with Ingersoll's surviving sister-in-law, Mrs. C. P. Farrell of New York, and gets from her the unequivocal statement that Ingersoll used the steel rail story as early as 1880. She refers to a speech made in Brooklyn, New York, in October, 1880, and reported to the New York *Herald* of October 31 of that year. He used it also in an interview in the *Republican* of Denver, Colorado, on January 17, 1884, and once more in a speech at the Metropolitan Opera House on June 29, 1888. The evidence seems to be complete. Ingersoll was the author of the phrase, and used it frequently. Only by accidental collocation with Lincoln's name did it come to be ascribed to the great president.

[1] Reprinted in the volume of collected essays on Free Trade, The Tariff and Reciprocity (1920).

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